

## PwC response to the Liability, Insurance and Settlements working paper

- 1 This paper sets out PwC's response to the Competition Commission's (CC) Liability, Insurance and Settlements working paper (the **Liability WP** or the **Paper**).<sup>1</sup> We provide corrections to some points of detail in the Annex.
- 2 We note the CC's preliminary conclusion that adequate levels of insurance are accessible to mid-tier firms on equivalent terms<sup>2</sup> and it therefore follows that the cost of insurance and management of liability is not a potential barrier to entry or expansion.
- 3 However, while insurance may be accessible to all firms, and therefore is not a barrier to entry or expansion, the risk of unlimited liability (and the price of mitigating it) is a material cost of doing business for audit firms. Claims by FTSE 350 companies against audit firms have declined over the last 12 years for three reasons:
  - (a) a sustained emphasis on quality in the provision of the audit;
  - (b) enhanced risk management processes; and
  - (c) a reasonably stable economic environment (up until 2008).<sup>3</sup>
- 4 The success of firms in reducing their litigation exposure is testimony to the improved levels of quality in the provision of the audit and to the investment in risk management processes which assist in identifying and resolving potential issues as they arise in individual audits.
- 5 This can be contrasted with the levels of exposure in the past that led commercial insurers to associate major audit firms with a sharply increased level of risk of claims. This resulted initially in higher premiums and, by the early 1990s, led to commercial insurers withdrawing from the large firm audit market completely. Notwithstanding the improved claims record in more recent years, we are not able to obtain third party commercial insurance cover on terms that are economically acceptable.
- 6 We shall comment further on the nature and extent of the liability and other risks we face in our responses to other working papers as appropriate.

**PricewaterhouseCoopers LLP**

**19 October 2012**

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<sup>1</sup> We note that the Paper is a part of the CC's assessment of potential barriers to entry or expansion as per paragraph 12 of the Restrictions on Entry or Expansion working paper ("*Factors arising from the regulatory system*").

<sup>2</sup> Paragraphs 47 and 52 of the Paper.

<sup>3</sup> See paragraph 6.65 of our Submission and Response to the Issues Statement (12 January 2012).

## ANNEX

In this Annex we comment on some points of detail in the Paper by reference to the paragraphs in question.

1.1 **Paragraphs 6 - 8:** We make three points of clarification:

- (a) In our Response to the Law and Regulation working paper, we clarified that auditors owe a duty of care to the members of the company as a group (not individually) and therefore references to "the claimant" should be to "the members" in the context of a claim for negligence.<sup>4</sup>
- (b) The second sentence of paragraph 6 does not reflect that the heads of liability identified are limited to those under English law.
- (c) The "heads of liability" section is not a complete summary of all heads of claim which an auditor may face. In addition to the heads of liability identified (negligence, professional and criminal), under English law, auditors also face potential claims for breach of contract and tortious liability for fraud and deceit (in lieu of misstatements amongst other things), as well as other types of potential criminal liability (for example, in respect of anti-bribery and money laundering laws).

1.2 **Paragraph 11, Footnote 5:** Reference to "CCA 2006 section 536(2)" should read "CA 2006 section 536(3)", as section 536(3) relates to authorisation by shareholders of a public company.

1.3 **Paragraph 42:** The final sentence as currently drafted seems to suggest that audit firms have profit sharing agreements with captive insurers, which is not an accurate reflection of current practices.

1.4 **Paragraph 45, Table 1:** It is inappropriate for the title to be "*Value of claims against insurance*" (emphasis added). Firms have a sizeable deductible to pay before any claim is paid out under the PII insurance policy.

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<sup>4</sup> See paragraphs 3.47 - 3.49, Response to the Law and Regulation WP, 4 May 2012.