

Response to the update paper on

Statutory audit services market study

21 January 2019

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Background

Rothesay Life is a leading provider of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, Rothesay Life has grown to become one of the largest annuity providers in the UK market, with over £36bn of assets under management and insuring the annuities of over 770,000 individuals.

Rothesay Life is privately owned but is a public interest entity. If Rothesay Life were to IPO then our likely market capitalisation would mean that Rothesay Life would be in the FTSE 250.

Our response to this paper has been prepared by management and reviewed by the Audit Committee.

A) Issues

1. Audit quality

We share the view cited in the paper of Audit Committees and investors that audit in the UK is generally of a high quality. There will always be a gap between the role of the auditor and the public's view of what the audit should achieve, although we agree that this should not be used as an excuse for inaction.

Although not within the remit of the CMA's study, we believe that more could be done to streamline company reporting to make it harder to obfuscate and that some accounting standards could be improved in order that the accounts provide greater clarity.

From a Rothesay Life perspective, we believe that our external auditor (PricewaterhouseCoopers):

- Undertakes a robust audit
- Exercises appropriate skepticism
- Challenges our assumptions appropriately
- Is appropriately independent

2. Competition and other issues

We share the view of the CMA that four credible firms is not enough and that this raises resilience concerns. However our experience is that the four firms compete strongly and that this does not impact audit quality. In addition, we do not believe that potential solutions to this issue should impose additional cost on the users of audit firms.

Rothesay Life's Audit Committee ran a competitive tender process in 2016 and recommended the selection of PwC.

In selecting the auditor, the Audit Committee was most focused on audit quality and breadth of experience of the team and wider firm. For these reasons, the Audit Committee did not invite any challenger firms to tender.

PwC's proposal was significantly more expensive than the cheapest proposal received and this did not prevent them from being selected.

As noted above, it is not our experience that limitations on choice lead to weaker competition. All of the firms approached to tender for the audit responded and they all appeared to take the process seriously.

The Audit Committee ensures that non-audit work undertaken by PwC does not create inappropriate incentives and believes that the multi-disciplinary nature of PwC means that it can access specialist resources required to undertake a more robust audit.

It is also worth noting that the Prudential Regulation Authority (PRA) already has significant powers in relation to the operation of the Audit Committee. For example, the Senior Insurance Managers Regime (SIMR) means that the PRA must approve the appointment of the Chair of the Audit Committee and ensures that there is individual accountability through a set of conduct standards.

The PRA's safety and soundness and policyholder protection objectives are served by a supervisory approach which includes "reliance with confidence" in audited financial information. Supporting this confidence is the open relationship between the supervisor and the auditor in the context of particular firms. This is discussed in the PRA's Supervisory Statement LSS7/13 - "The relationship between the external auditor and the supervisor: a code of practice".

Given the PRA's oversight of insurance companies, consideration should be given to excluding regulated insurance companies from the scope of some of what is proposed and argues against a blanket inclusion of all public interest entities alongside FTSE 350 firms.

B) Remedies

We have only responded to some of the questions raised.

3. The shareholders of private companies tend to be more closely involved with oversight of the business and hence less exposed to the issues raised in the update paper. On that basis, we would argue that the remedies are more applicable to publicly owned companies.

In addition, as a regulated insurance company, Rothesay Life is considered to be a public interest entity but we believe that the PRA already has appropriate powers to address many of the issues raised in the update paper.

4. **Remedy 1: Regulatory scrutiny of Audit Committee**

As noted above, the PRA already provides some regulatory scrutiny of the operation of the Audit Committee.

The requirement for the Audit Committee to report directly to the regulator before, during and after the tender selection process does not seem unreasonable provided such reporting is not unduly onerous and does not introduce excessive time delays.

We have more concern with the bureaucracy involved in demonstrating that audit quality is considered by the Audit Committee. In addition, material disagreements may be very rare because such disagreements will not arise if management is behaving reasonably (and particularly if management consults the audit firm in advance of finalising accounting approaches).

The regulator should have the power to issue public reprimands in situations where Audit Committees have ignored the regulator's guidance or have deliberately failed to follow proper procedures. However we do not believe that it is necessary for the regulator to attend Audit Committee meetings.

5. – 9. **Remedy 2: Mandatory joint audit**

We can see no benefit from mandatory joint audits. Joint audits are likely to increase cost, reduce choice further (in relation to non-audit work), reduce accountability between the audit firms and increase the risk of an ineffective audit. AQRs sometimes criticise the communication between teams within the same audit firm; across firms communication will be very challenging. In addition, use of two audit firms would represent more of a burden for companies, slowing down financial reporting and increasing financial reporting costs.

It is also hard to see how the scope of an audit could sensibly be split for a mono-line business such as Rothesay Life.

10. **Remedy 2A: Market share cap**

We are not in favour of an artificial market share cap if the result were that the Audit Committee was prevented from selecting its preferred firm(s).

13. **Remedy 3: Subsidy scheme**

We are not in favour of a subsidy scheme for challenger audit firms if that resulted in additional costs for companies.

19. **Remedy 5: Full structural or operational split**

We believe that audit quality is best achieved where a firm is multi-disciplinary and can access the specialist resources required to undertake a robust audit. In order to achieve efficient audits, firms must be permitted to use staff from either side of the split on audits or on non-audit work. However it is important that firms can demonstrate that their audit business is sustainable on a standalone basis (and are not reliant on subsidies from the non-audit business).

In addition, it is important that increased regulation and heightened personal risk don't act as a barrier to audit firms recruiting high calibre staff and partners.

22. Given our answer to 19, it is hard to see how current restrictions can be relaxed.

24. It is important that the audit firm is still able to provide other assurance services in order to ensure that such services are delivered in a cost efficient and effective manner. The current regime provides appropriate restrictions in our view.

27. **Proposal not to make a market investigation reference**

We agree with this proposal as we are not convinced that the problems identified in the CMA's review relate to competition issues.