



RPC



**Professional and Financial Risks**  
Overview of  
the key issues  
affecting the market

October 2023

# Introduction

On 5 September 2023, RPC welcomed key clients from the insurance market to a panel event where partners from the Professional and Financial Risks teams reviewed recent and future market changes. The panel focussed on Professional Indemnity claims against accountants, lawyers, technology professionals, insurance brokers and construction professionals. They discussed the impact of COVID, regulatory changes, ESG, AI and broader past and future developments.

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## Panel 1: chaired by Will Sefton



Will Sefton



Natalia Jeremiah



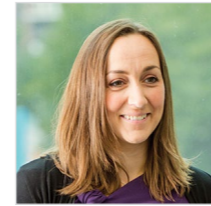
Scott Ashby



Ben Goodier



Richard Breavington



Kirstie Pike

### What do you think has been the biggest impact of the COVID pandemic in your market?



**Natalia Jeremiah (Accountants):** We've seen a spate of claims made against accountants, predominantly where it has been alleged that they missed deadlines or failed to enable clients to make applications for financial support under government schemes. But these types of claims have largely already been dealt with, and their impact on the profession and its insurers has been relatively modest.

The bigger impact in terms of future claims is likely to be the impact of lockdown and homeworking. This switch created challenges, particularly for auditors, around the difficulties of supervision and not having physical access to client workspaces and systems. We've yet to see claims coming out of this, but it's likely that we'll see these coming through in the next few months or years.

There's also the broader economic impact of COVID and Brexit, along with other recent political and geopolitical developments. It's clear that where there are corporate collapses there will likely be allegations made against those who have

prepared or audited the accounts in the run up to these collapses.

**Scott Ashby (Lawyers):** Lawyers generally are a somewhat traditional profession, where particularly pre-pandemic there was a general lack of tech. As we've then seen a move to working remotely a significant volume of errors have been made.

Having spoken to the risk managers of both top-200 firms and smaller firms, they are largely saying that these would not have happened if people were still in the office. For instance, issues around not serving documents properly, or clauses not being correctly drafted, and so we have seen significant growth in this area of disputes.

**Ben Goodier (Construction):** The biggest impact has been inflation, although it's not just COVID which has caused this. The construction industry has suffered badly from inflation through three specific areas: 40% attributable to Brexit, 40% to the Ukraine energy crisis and 20% to COVID.

We've also seen an increase in the cost of materials, labour and tender prices, which has led to far less certainty in the costs of projects. Since Brexit, the cost of construction materials has increased by 60%, the cost of labour by 30% and

we've seen a decline in the construction workforce by around 330,000 people. This has hugely increased the risk to projects and companies, particularly where there are historically such small margins within the construction sector. Contractors who were already working on small margins need to either increase their prices, or work off even slimmer margins. As such, we're also seeing that insolvency has increased significantly.

The best response to this is collaboration; particularly between employers and contractors and looking at how contracts can be varied or amended to keep them workable. From a claims point of view this might be looking at what we can do to end a claim now and to take a hit with long term benefits. After all, collaboration ultimately benefits the employer if it keeps the contractor solvent.

**Richard Breavington (Tech PI):** Following COVID we've seen increased digitisation and increased data hosting. A lot of these companies have focused on getting the initial job done, rather than the processes which are being put in place, which is of course ripe for disputes, particularly when combined with some poorly drafted contracts.

**Kirstie Pike (Brokers):** Insurers have been incredibly busy assisting their clients with insurance claims, but the initial rejection of claims immediately led to a significant number of notifications to brokers' E&O insurers. We previously believed that any claim against a broker would be difficult to win due to issues in proving there had been a breach of duty, as it would presumably require that brokers had a duty to predict a global pandemic. It also looked like causation would be difficult to make out since, if the insured had been

offered a policy with greater cover, would it really have paid the increased premium? The Supreme Court decision in the FCA test case also alleviated many of early fears as a lot of policies were found to respond to covid-related BI losses.

However, in the summer of 2022 there were press reports of 70 to 100 nurseries who were intending to bring a class action against a specialist nursery broker and, in July 2023, a claim was issued by the owner of a hotel portfolio against its broker.

Both claims allege that wider business interruption cover than the claimants were offered was available at the relevant time. While both of these claims seem to be relying on hindsight, if there is merit, it may suggest that brokers and their E&O insurers are not yet out of the woods and these claims have the potential to open the floodgates.



### What has been the key regulatory change over the last couple of years?



**Natalia Jeremiah (Accountants):** Audit reform has been in the pipeline for years, precipitated by a number of high-profile corporate collapses: BHS, Carillion, Patisserie Valerie. Since then, we've seen a number of reports and the BEIS White Paper and consultation process, culminating in a government report in June 2022 setting out the scope of wide-ranging audit reform.

Key elements of this reform will require legislation, which will include setting up a strengthened statutory regulator ARGA (Audit Reporting and Governance Authority), bringing company directors within the scope of its authority, expanding the definition of Public Interest Entities and encouraging operational separation of audit and non-audit services within larger accountancy firms. But, despite a lot of talk about this in 2022, the Government has not prioritised introducing this legislation and

we now know that it will now be included in the King's Speech in November 2023. The current regulator, the FRC, has indicated that it does not expect the strengthened regulator (ARGA) to be up and running until 2026-2027.

**Scott Ashby (Lawyers):** The regulatory changes have predominantly been driven by the SRA and their appetite for risk. It's now less the case that the SRA are giving us a set of stringent rules to abide by, but there has been a creeping remit around what the SRA are looking for. For instance, we've seen this with the trainee who left the briefcase on the train and then stayed silent about it. The SRA are also now much more interested in sexual misconduct and we've seen someone struck off for sexual misconduct which was not criminal. This is part of a change of appetite which will continue to grow. The SRA are looking at increased fining powers and potentially unlimited fines for serious misconduct. The SDT is pushing back on this, but this is the regulatory landscape that we are looking at.

**Ben Goodier (Construction):** Looking at RICS and ARB we have seen an increase in regulatory investigations getting to the Professional Conduct Committee stage. Particularly regarding the ARB, where the number of complaints has stayed roughly the same but the number that are reaching PCC has increased from four in 2018 to forty-four in 2022.

I also want to highlight for anyone looking at these how extremely stressful they are for those involved. In addition, the initial letter of response needs to be drafted incredibly carefully to ensure that no admissions are made and that any of the fiery language that the individuals might be inclined to use is toned down. From inception it's also important to understand whether the individual is covered for the cost of a disciplinary hearing. There is often a sub-limit given for the initial correspondence, but the individual can easily run out of funds for representation. So, it's important to ensure that the individuals know whether they are insured or not.

## Panel 1: chaired by Will Sefton (continued)

**Richard Breavington (Tech PI):** Generally, we are seeing increased regulation around tech. There is so much data stored digitally and it's difficult to delete, so often these companies have a lot of customers' data, which means that from a regulatory and contractual perspective it's important to be clear on how they are using this data. They also need to be clear on whether their role is one of a data controller/processor/transferor, with the latter being increasingly fraught post-Brexit.

We know that insureds need to keep data secure due to the prevalence of cyber incidents and the ICO (the regulator) is beginning to take more interest in security measures and so tech companies will not get away with poor security measures.

**Kirstie Pike (Brokers):** The biggest change has definitely been Principle 12 and the introduction of the Consumer Duty. We're seeing the FCA move from a rules-based regulation to an outcome-based approach (as Scott has discussed in relation to the SRA).

Underpinning this duty is the concept of reasonableness, where firms are required to avoid causing foreseeable harm, which may include properly explaining the duty of fair presentation or the claims process. Not only do brokers have to comply with this duty, but they must also demonstrate compliance, through additional record keeping. The direct consumer contact between customer and broker means that brokers are likely to have more onerous obligations than others in the supply chain. To align with its work on inclusion and

diversity, the FCA also now requires brokers to consider "vulnerable" clients and so standard wording must factor in a range of consumer characteristics to ensure that the communication is presented in a clear enough way to be understood by everybody.

At present, the duty does not confer a private right of action on consumers, but this has not been totally taken off the table by the FCA, and claimants who bring civil negligence actions will undoubtedly allege that a breach of Principle 12 equates to negligence, much like they currently do with ICOBs.

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trying to use the SAAMCO "no transactions" style argument to make claims. We've also seen large growth due to the turbulence around COVID, particularly leading to a growth in litigant in person claims. COVID pressures and financial pressures caused a growth in litigants in person as claimants with less money choose to pursue claims themselves.

**Ben Goodier (Construction):** We're also seeing a growth in litigants in person in construction, but the courts are being less lenient and are more willing to grant strike-out applications.

Cladding is obviously also a huge issue and the use of mitigation clauses is growing, which is good news as they are effective at reducing the value of claims. So, we should be encouraging the use of them, even if they are practically difficult. The broker and

insurer should collaborate on these as they are a good way to reduce the cost of claims.

**Richard Breavington (Tech PI):** We've seen a growth in disputes, which is unsurprising as there has been a growth in tech projects and these are unforgiving on timescales. But we are starting to see that, although these are not really suited to the courts, a larger proportion of disputes are starting to be put in front of courts, for instance covering precise contractual wording as with Drax. The current approach is somewhat all or nothing on exclusion or limitation clauses, but we're starting to see more authorities come through on this which should make things clearer.

**Kirstie Pike (Brokers):** Although it's been more than a couple of years since it came into force, the Insurance Act 2015 has had a recent an impact, as it's taken a number

of years for any claims under the Act to make their way through the courts. The Act updated the 100 year-old law on the duty of disclosure to introduce the duty of fair presentation. 2021 saw the first decision on this duty, in Berkshire Assets (West London) Limited v AXA Insurance UK Plc. This year we've also had the decision on George on High Limited and George on Rye Limited v (1) Alan Boswell Insurance Brokers Limited (2) New India Assurance Company Limited. While neither decision raises any new issues for brokers, they highlight the importance of what they should be doing around a duty of fair presentation.

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## Not including things you've already mentioned, what do you think has been the key development in your market in the last couple of years?

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**Natalia Jeremiah (Accountants):** The biggest decision recently has been the Supreme Court in Manchester Building Society v Grant Thornton UK LLP in June 2021, which set out a new 6-point framework for analysing tortious claims, including two limbs stipulating greater emphasis, when assessing the scope of a duty, on the purpose of the retainer and the extent to which this duty entailed protecting the claimant against the risk of the harm which is now said to have materialised.

We're continuing to evaluate the impact of this 'new' framework, as well as the continuing role of the SAAMCO counterfactual. It looks like generally we are seeing an increase in the number of "no transaction" cases, where claimants seek to argue that without this advice they would not have entered into this transaction and so are entitled to losses flowing from it. Claimants appear to have been emboldened by the diminishing prominence of the SAAMCO counterfactual in MBS v GT to pursue these increasingly creative lines of argument, although whether they will be successful in this is another question! As for the six point framework, by and large we are seeing this being interpreted in a pretty

restrictive way, rather than opening the doors to new categories of claim.

**Scott Ashby (Lawyers):** There has been a growth of claims as some clients almost appear to be expecting lawyers to be business advisors. They are missing the question of what lawyers are actually instructed to do and moving away from the area of defined advice retainers.

However, the greatest impact is the turbulent economy, where the vast majority of these claims come from the property or conveyance sector due to the market's volatility. Lenders get involved in repossession work and they will then be



## Panel 2: chaired by Graham Reid



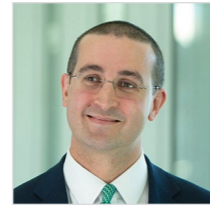
Graham Reid



Rob Morris



Tom Wild



Tom Green



Richard Breavington



Laura Stocks

### What do you think will be the impact of ESG in your market in the next couple of years?



**Rob Morris (Accountants):** ESG-related issues have already been impacting financial and other corporate reporting, and thus impacting accountants and auditors. It's already an audit requirement to report any inconsistencies in ESG statements made within a company's annual report against matters established as part of an audit. So, there's likely to be an increasing demand for auditors to check and report on such matters, as part of the introduction of increased corporate governance requirements like Resilience Statements and Audit Assurance Reports. Although this will have the biggest impact on the Big Four, there is likely to be substantial trickle down.

It's also likely that we will see claims against auditors or accountants where companies fail and it is said that the auditor ought to have detected financial or non-financial inaccuracies, particularly if this led the company to incur liabilities it might otherwise have avoided.

**Tom Wild (Lawyers):** There are two angles to this. There is a direct client demand for ESG expertise, with a recent study suggesting that three years ago 25% of law firms in Europe in the US had an ESG

practice, which is now over 75% and it's likely that this advice will continue.

Secondly, in relation to ESG within law firms themselves, many clients are asking for their firms' sustainability credentials or ESG policies, in order to meet their own reporting obligations. For instance, we've seen Slaughters and Eversheds be the target of Extinction Rebellion protests, but this is part of a wider trend of firms being forced to face up to these issues to manage their reputation.

**Tom Green (Construction):** A move to net zero requires infrastructure growth and a substantial amount of innovation, but this in turn creates risk. Although we need new infrastructure, materials like concrete and steel include huge carbon loads and so it's likely that the construction sector will need to invest in new materials, and new ways of working to reduce carbon in the supply chain, but innovation in design and process will increase the level of risk. Arguably this was a factor in how the use of potentially problematic cladding materials came about; through an adoption of new materials due to a desire to improve the thermal efficiency of buildings. From a social perspective the construction industry needs to change to become more diverse, as currently we're looking at 15% of the workforce being women, which drops down to 2% on site.

A more diverse workforce, will produce better design solutions, and therefore a corresponding reduction in risk.

**Richard Breavington (Tech PI):** We're seeing a lot of focus on the areas of online harm in relation to tech companies, with a bill in relation to this currently going through the House of Lords. This will impose statutory duties on website hosts who are hosting user generated content, which will then cover a hugely broad spectrum of content. The possible fines are huge; 10% of revenue or £18 million for a breach, as well as the possibility of taking the website down. There are also substantial steps being taken against fraudulent advertising.

**Laura Stocks (Brokers):** Brokers are an integral part of the supply chains, but this requires evidence of ESG compliance and so they need to get their own ESG house in order. Brokers need to appreciate the rapidly changing ESG landscape in each business area so that they can properly identify and advise clients on their insurance needs. As insurers are now incorporating ESG into their underwriting strategies, brokers need to appreciate how these affect insurers' risk assessment and underwriting appetites.



### What do you think will be the impact of AI in your market in the next couple of years?



**Rob Morris (Accountants):** AI is already being used and it raises the possibility of real-time audits, but it also raises systemic risk as errors in programming or application could impact multiple clients. Overall, however there is less risk of human error, which is the driving force behind a lot of claims. AI should apply professional scepticism and it won't seek to bend rules just because the client is a longstanding friend!

**Tom Wild (Lawyers):** Obviously Chat GPT has been the big story in AI over the past year, but although it's being used in the legal market, it's not inherently transformative and it also brings a lot of issues with it. I've tried to use it for drafting but it has a tendency to make up case precedents, as we've seen in the case of the two US lawyers who were fined for precisely this issue, where Chat GPT created fictitious precedents which they then cited.

**Tom Green (Construction):** This question goes to the fundamental tension between time, cost and quality. Within the construction sector there has been a long push for an increased use of technology, BIM modelling is a good example of this, which is now very prevalent.. The application of AI to the existing technological advances in construction is very exciting. For instance, will AI allow the design information in a BIM model to be analysed at the conceptual stage to highlight where potential issues may be so that they can be resolved before work starts on site. If things do go wrong, AI working with the technological advancements already being seen may allow us to isolate discrete areas of dispute quickly and efficiently to enable speedy resolution.

However, this then raises interesting questions around who would be liable if there are issues with the AI; if the AI is used and is somehow flawed, then does this then become a tech issue rather than a professional indemnity issue?

**Richard Breavington (Tech PI):** AI is built into the growth of tech. Tech is a fundamental part of its foundational model,

as the data sets and their output need to be interpreted. These foundational models of AI require huge amounts of data and it's unclear how this plays into copyright or IP laws. The government have issued a very pro-business paper, but there has then been a partial row-back from this. In addition it needs to be evaluated whether the data coming from this is then anonymised and tracked. But overall, a lot of this is very unclear and needs work to clarify it.

**Laura Stocks (Brokers):** AI is having, and will continue to have, a substantial impact within the insurance market, particularly as insurers are embracing AI technologies. There has been a rapid commoditisation of the lower end of the market, as well as improving efficiency and productivity. We're particularly seeing an increased use of chatbots, voice assistants and smart contracts in client facing elements like websites. Just as Zurich have been experimenting with Chat GPT to analyse claims data, brokers may use this to better support and understand the market and address emerging risk.



## Panel 2: chaired by Graham Reid (continued)

### What other trends or developments do you think will have an impact, positive and negative?



**Rob Morris (Accountants):** Economic conditions are very important in claims against financial professionals and, along with increased regulation, this may lead to higher levels of risk for these professionals. Corporate insolvencies after all are often a very good indication of claims. While our Restructuring and Insolvency team believe that the majority of these insolvencies are amongst smaller companies which are more planned than distressed, they also consider that the impact of increased interest rates and a slowdown in spending has yet to hit.

**Tom Wild (Lawyers):** There's scope for changes in delivering legal services across the market as the economic climate has clearly changed a lot over the past couple of years. At one end of the market the extension of the fixed cost regime will have an impact on lower-value disputes, but at the other end the biggest change has been the growth in private equity. In particular, the impact of US firms in the London market over the past 10 years and the ensuing growth in salary wars.

**Tom Green (Construction):**

The construction industry is likely to face a substantial cultural change as a result of the Hackitt review, as we see a wave of legislative change. We've also seen substantial changes in the uptake of modern methods of production; new methods of working often produce greater risks for designers. In addition, the tech requirements for buildings is ever increasing, potentially posing increased challenges for M&E (mechanical and engineering) contractors and consultants. For instance, over the past ten years the M&E required in buildings like logistics and data centres has changed hugely, and is vastly more complicated. These are the buildings that are increasingly being built.

On current information, what appears to be less of a risk to the PI market is claims around RAAC (Reinforced Autoclaved Aerated Concrete). It appears on current information that the material was being phased out by the early 1990s within the UK. Limitation may well therefore be an issue for potential claimants thinking of pursuing designers/specifiers. That could be less relevant if the RAAC was used in residential dwellings, which may give the claimant a cause of action under the Defective Premises Act with its 30 year retrospective limitation period. However, as yet we have

not seen wide spread evidence of the use of RAAC in residential buildings. Surveyors should also be aware of the issue, but our understanding is that RICS has been publishing the issue to its members for some years now.

**Richard Breavington (Tech PI):** Data regulation is only going to increase, for instance in addition to the new online harms bill we are looking at the imposition of other relevant regulations, including duties around data security and other European regulation for tech companies. There's generally lots more risk that tech companies need to be insured against.

**Laura Stocks (Brokers):** All the areas discussed have demonstrated the rate of change within various lines of business. For brokers, it's important that they consider what they need to grapple with and the hardest part is keeping pace with business in changing regulatory environments. For instance, some brokers missed notifications on cladding because they didn't foresee it having such an impact. As such, the largest risk is not keeping on top of the market in this way.



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