

9 March 2015

Royal Commission into Institutional Responses to Child Sexual Abuse

Submitted by email: redress@childabuseroyalcommission.gov.au

Dear Sir/Madam

CONSULTATION PAPER: REDRESS AND CIVIL LITIGATION – JANUARY 2015

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. The ICA appreciates this opportunity to provide a submission in response to the Royal Commission's Consultation Paper, 'Redress and civil litigation'.

The ICA and our members acknowledge the suffering of survivors of institutional child sexual abuse, the life-long effects of this abuse and the need for reform to better protect children.

We also acknowledge that the current mechanisms available to seek redress, financial support or compensation are often inadequate to address and meet survivors' needs. The Royal Commission and stakeholders have faced a very difficult task in exploring options to provide fair, accessible and meaningful support for survivors. In this context, this submission provides information about the operation and interaction of general insurance in this area, as well as implications of reforms being considered by the Royal Commission.

If an institution has liability cover for the risk of sexual abuse, insurance is a source of compensation if a survivor of such abuse makes a successful claim against an institution for breach of duty of care.

The ICA therefore believes that affordable and available insurance benefits survivors, institutions, and the community more widely.

The role and value of general insurance

General insurance is an arrangement where an individual or entity is compensated, generally financially by an insurer for a pre-defined event or misadventure. An insurance policy is a contractual promise to provide assistance in accordance with the contract in exchange for the payment of premium.

Insurance is widely used as an accessible and common form of risk management to protect against the risk of uncertain future losses. Insurance facilitates economic activities, enabling

many activities to be undertaken that would not otherwise take place, and is an effective mechanism for pooling and transferring risk.

However, not all risks are insurable, or are risks that insurers opt to insure. As outlined by the Geneva Association,¹ two conditions must generally be met before insurers are willing to offer coverage against an uncertain event. The first is the ability to identify and quantify or estimate the probability and consequences of the event occurring. The second is the ability to set appropriate premiums or rates for each potential customer or class of customer. If these conditions can be met, a risk can be considered to be insurable. However, insurers may still not elect to cover the risk if it is not possible to specify a premium that is affordable, that will provide sufficient income revenue to cover expenses and claims costs, and still yield an acceptable return.

Unlike other industries, a large portion of the ultimate costs are uncertain for insurers when they distribute their products. Uncertainty or ambiguity is a key factor that will influence insurance premiums. The higher the uncertainty, generally the higher the premium will be.

The premium paid by the policyholder needs to be sufficient to cover the cost of claims, the insurer's internal expenses (inclusive of commissions to intermediaries such as brokers), reinsurance, the cost of regulatory capital, and a reasonable return on capital. These costs are offset by investment income made on reserves held by insurers. The level of insurance premium will vary from one policyholder to the other based on the specific risks and circumstances of the policyholder.

Underwriting is the way an insurer works out how much to charge for each risk they cover for each person or organisation who buys an insurance policy and under what terms. Underwriters think about a number of different things when working out the price of a particular risk for insurance. Every insurer has its own set of underwriting guidelines to help the underwriter determine whether or not the company should accept the risk of a particular situation. Insurers make an assessment of the risk, the coverage to be provided and set premiums based on that information which they consider will be sufficient to cover their projected liabilities.

The general insurance industry in Australia provides insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as public and product liability insurance, commercial property insurance, professional indemnity insurance and directors and officers insurance). ICA members also underwrite various mandatory, statutory insurance schemes across Australia.

How liability insurance works

It is also useful to provide a brief outline of how liability insurance works in relation to sexual abuse, or “molestation risk”.

¹ The Geneva Association, Risk and Insurance Research, No 5, *Extreme events and insurance: 2011 annus horribilis*, March 2012.

Public liability insurance is a good example. It typically provides financial protection up to agreed limits for individuals and entities against the risk of being found legally liable to a third party for death or injury, loss or damage of property or economic loss resulting from their or their employee's (or other people in their supervision or control) negligence.

A common example of public liability insurance in action is when a person (Party A) sustains physical injury as a result of the negligence of another party (Party B). In this situation Party A may commence legal proceedings in negligence against Party B on the basis it was the alleged negligence of Party B that caused their injury. If Party B holds a public liability insurance policy, they can make a claim on their policy. Provided the claim is covered under the terms and conditions of the insurance policy and Party B is liable (or in the view of the insurer likely to be found liable), their insurer will pay compensation to injured Party A as well as legal fees the parties have reasonably incurred.

As with all insurance, public liability policies usually have some 'exclusions'. Exclusions outline certain types of claims that arise from certain high risk activities or specific acts that will not be covered under the insurance policy. For example many public liability policies exclude liability or injuries arising from the use of asbestos.

Similarly, most liability policies do not cover injury arising from criminal acts or conduct - for example sexual abuse is not something to which insurance would generally respond. However, entities have been able to obtain insurance coverage for claims that would be otherwise excluded in their public liability insurance policy by agreeing to pay an additional amount of premium in exchange for this additional insurance coverage. This is what commonly occurs if an entity wishes to have insurance coverage for compensation claims made against them arising from sexual abuse by people they employ, supervise or control. These insurance arrangements are considered on their merits and are underwritten and priced based on the insurer's assessment of the risk given the coverage at the time the contractual arrangement is entered into.

Limitation periods

The ICA acknowledges that limitation periods can be an obstacle to some victims of past institutional sexual abuse.

However, as acknowledged by the Royal Commission in the Consultation Paper (p 33 and p 204), limitation periods do play an important role in the claims process. For example, they encourage victims to institute proceedings and resolve claims as soon as reasonably possible, and they can ensure that defendants are not unnecessarily prejudiced through delay in pursuing a claim.

Limitation periods are also taken into account in the process of underwriting and pricing public liability risks, and prudential management and planning.

Implications for insurers

Changes to limitation periods may pose challenges to insurers of institutions. Insurance, as outlined above, is a contractual arrangement entered into at a point in time. The coverage

provided and premium charged for that coverage is based on the insurer's best assessment of the risk involved at the time the insurance arrangement is entered into.

Any retrospective removal or extension of limitation periods could lead to circumstances in which a relevant insurer may be exposed to claims from a policyholder for which it has not collected sufficient premium. This is because the basis on which the insurer priced the insured's liability risk would not have factored in the increased risk of liability exposure any retrospective changes to limitations periods would bring.

Similarly, a retrospective change to limitation periods would also create challenges for insurers in relation to prudential management. If a significant number of claims are made against an insurer as a result of legislative adjustment, this could have a substantial impact on the capital position of an insurer, that, having priced policies and reserved funds to meet claims based on existing limitation periods, finds itself having under-reserved and under-priced the underwritten risk. This effect would also flow through to the reinsurers of these insurers. Given these implications, particularly in relation to possible pricing and prudential impacts on insurers, it is the ICA's position that careful consideration be given to the certainty these limitation periods provide, and the potential impact retrospective changes to limitation periods may have.

Changes to civil litigation and the onus of proof/duties of institutions

The Royal Commission has sought feedback on options for reforming the duties of institutions, in particular expanding the circumstances in which an institution could be found liable for child sexual abuse.

The ICA wishes to highlight the potential impacts on affordability and availability of liability insurance for institutions that may flow from changes to the nature of the duty of care of institutions. As outlined above, not all risk is insurable and changes in institutions' liability exposure will change the nature of the risk for insurers. This is likely to adversely impact the affordability and availability of liability insurance for these institutions.

Institutions, businesses or organisations whose activities involve children are, from an insurance perspective, a high underwriting risk. Children, because of their age, level of development and experience in life, are more vulnerable to injury or abuse. As such, institutions that provide care and services to them are already subject to a more onerous standard of care and supervision than other service providers and organisations that do not have any direct association with children.

For example, a 'reasonable' level of supervision schools and their employees are required to have of their students is higher than the level of supervision a business or manager is required to have over their office employees.

Consequently, public liability premiums for these institutions are likely to be substantially higher than other institutions to reflect this more onerous duty of care and the increased liability exposure this brings.

Given the high underwriting risk, some insurers in the Australian market have elected not to offer insurance in this segment of the market.

For insurers who do provide liability insurance to these institutions, liability coverage for sexual abuse committed by employees (or people in the institution's control) is typically excluded in the standard policy and only provided as an 'extra' form of coverage for which an insured must pay additional premium.

Expanding the duties of institutions will increase the cost of insurance coverage

Expanding the circumstances in which institutions could be found liable for institutional child abuse could further increase the underwriting risk and uncertainty for insurers who operate in this sector of the insurance market – and this would be reflected in higher insurance premiums.

It is in the interests of the community and institutions that insurance coverage for this kind of risk is available and affordable.

For this reason, and given the existing high liability risk of institutions, the ICA cautions against expanding the nature of the duty of care owed by institutions without due consideration of the potential impacts on the affordability of insurance.

Of particular concern for the industry is legislative reform that would pose a reverse onus of proof or strict liability on institutions.

If these reforms are applied retrospectively, they could have a similar effect as outlined above for the retrospective removal or extension of limitation periods.

If these reforms are applied prospectively, it is highly likely that the availability and affordability of liability cover for molestation risk will be adversely affected. For this reason we are not supportive of reforms to the nature of the duty of institutions.

Reforms in relation to the responsibility of institutions must focus directly on improved practices and risk management that will reduce the likelihood of sexual abuse occurring.

A sound risk management approach by relevant institutions can also support the affordability and availability of liability insurance to cover the risk of child sexual abuse.

Insurance for incorporated entities

The Consultation Paper raises the option of a requirement that only insured, incorporated entities can deliver children's services that are authorised or funded by government.

If federal, state or territory governments choose this option, the availability and affordability of liability insurance will be a paramount consideration for such institutions. Such a requirement could place insurers in a position of de facto licensors of these institutions. The introduction of a mandatory insurance regime is a complex process, and the ICA and its member companies would seek to discuss the details of this option with the relevant government should it be pursued.

Redress scheme

Given the nature of the risk involved and the challenges associated with civil litigation for a liability claim, the ICA supports the establishment of a Redress Scheme whilst recognising the inherent challenges in developing funding arrangements, and in determining the details of how the Redress Scheme will function.

The ICA believes these are vital public policy matters for governments to determine in consultation with all interested stakeholders.

Questions are raised in the Consultation Paper about how a Redress Scheme may operate in the context of existing common law rights for victims.

While we have outlined some of the potential effects on insurance of proposed reforms to expand civil liability settings, decisions impacting existing common law rights of survivors are rightly the domain of government, in consultation with the community.

The ICA would welcome the opportunity to be involved in any further consultation processes designed to determine details of any proposed reforms.

Yours sincerely

Robert Whelan
Executive Director & CEO