The Royal Commission into Institutional Responses to Child Sexual Abuse – Implications for Insurers

Prepared by Sharanjit Paddam

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Abstract

The recently established and ongoing Royal Commission on child sexual abuse could lead to substantial liabilities for liability insurers who have insured institutions in the last forty years. This paper explores the aims of the commission; the potential impact on insurers; and discusses approaches to estimating the exposure of insurers to claims from victims.

Keywords: public liability, latent claims, child sexual abuse, Royal Commission, exposure analysis
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1. **Introduction**

1.1 **Support**

Please note that if you have been personally affected by the issues in this article, immediate support is available at one of the following 24/7 national help lines:

- Lifeline 13 11 14
- MensLine Australia 1300 78 99 78

1.2 **The Royal Commission**

It would have been hard to avoid the news headlines over the last year of physical, mental and sexual abuse of children extending back over decades. With prominent members of churches and other institutions being examined in public hearings, the revelations have been shocking to many, and all too familiar to others.

The Royal Commission was a response to the public outcry about the abuse. The Commission’s work has only just begun, but as noted in its interim report (Royal Commission, June 2014), 3,309 victims have already come forward and there are still over 1,000 people waiting to tell their story.

The work of the Royal Commission could lead to substantial liabilities for insurers who have insured institutions in the last 40 years. This paper explores the aims of the Royal Commission, the potential impact on insurers, and how insurers might estimate their liabilities to such claims. It does not consider the important issue of the non-monetary impact of sexual abuse on victims, or the broader community issues of seeking to fund any redress compensation.

1.3 **Acknowledgements**

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- Martin Fry, Estelle Pearson, and Geoff Atkins
- Other members of the Actuaries Institute’s Working Group on a response to the Royal Commission on Redress Schemes
- Other members of the Actuaries Institute’s Discussion Group on Actuarial Issues in Relation to Claims Liabilities for Child Sexual Abuse.

1.4 **Previous work**

Substantial actuarial research into Child Sexual Abuse claims was conducted in (Moran, Nichols, & Konstantinidis, 2005), and I recommend this paper for further research.
Sections of this paper are based on my previous work published in the ANZIIF Journal (Paddam, 2014) and the Actuaries Magazine (Paddam, 2014).

1.5 The future

In many ways, the Royal Commission has so far raised more questions than answers for institutions and their insurers, as well as victims and other stakeholders. It is clear that sexual abuse in institutional settings has been a significant issue both in terms of its prevalence and the lasting harm to victims.

Addressing the consequences will have significant ramifications for both institutions and insurers; hopefully enable the survivors of past abuse to rebuild their lives; and also ensure that in future all children will get the care and protection they rightly deserve.
2. The Royal Commission

2.1 Background

In January 2013, the Australian Government announced the establishment of the Royal Commission to investigate the sexual abuse of children in both religious and non-religious public and private institutions in Australia since 1970.

2.2 Objectives

The detailed terms of reference for the Royal Commission are set out in its Letters Patent. Broadly, the purpose of the Royal Commission is to:

- Minimise the risk of child sexual abuse in the future by providing recommendations on policy, laws, administrative practices and structural reforms
- Provide victims with a forum through which they can talk about the abuse they suffered and gain acknowledgement that such abuse should not have occurred.

Note that the Commission’s purpose is focussed on sexual abuse, even though many of the victims suffered a wide range of physical and mental abuse. This paper, like the Commission, focusses on sexual abuse of children in institutions.

2.3 Compensation and criminal prosecution

Although the Royal Commission does not intend to address matters of individual compensation or criminal prosecution, there has been a special police unit formed to prosecute any perpetrators identified during the inquiry. As of 31 May 2014, the Royal Commission had referred over 160 allegations to the police (Royal Commission, June 2014).

2.4 Reporting

The Royal Commission provided an interim report on 30 June 2014 (Royal Commission, June 2014) which discussed the work to date, but made no recommendations. The final report is due at the end of 2017, by which time the cost of the Royal Commission will have reached half a billion dollars.

2.5 Similar previous inquiries

Australia

The Royal Commission follows 83 similar previous inquiries in Australia from 1852 to 2013 (Swain, 2014). Recent examples include the following.

- The Victorian Select Committee investigation in 2012-3 into the handling of child abuse in religious organisations and other non-government organisations.

- In 2012 Western Australia conducted a Special Inquiry into allegations of sexual abuse in hostels, which found systemic failures in the governance of hostels and recommended an ex-gratia redress scheme.

- In 2004-8 South Australia commissioned the Children in State Care Commission of Inquiry (known as the Mullighan Inquiry), which investigated allegations of sexual abuse and death of children in state care.

- In 2003-6 Tasmania’s Ombudsman for children published the Listen to the Children report, which arose out of media exposure of paedophilia in institutions for children, and recommended ex-gratia payments and counselling for victims.

- In 1999 the Queensland Commission of Inquiry into the Abuse of Children in Queensland Institutions (known as the Forde Inquiry) addressed allegations of sexual and other abuse at various institutions in Queensland.

**Ireland**

In Ireland from 1999 to 2009, the Ryan Commission into Child Abuse in Irish Institutions for Children led to the establishment of the Residential Institutions Redress Board to provide compensation to claimants. To 31 December 2013 nearly €1 billion has been paid to victims and in scheme costs, funded by the Irish Government with contributions from religious organisations and their insurers (Residential Institutions Redress Board, 2014). This example is particularly relevant, as the Royal Commission may also establish a redress scheme as discussed below.

Both the Victorian Committee and Irish Commission investigated the abuse of children of various kinds, whereas the Royal Commission is specifically focussed on sexual abuse.

### 2.6 Potential impact on institutions and their insurers

Whilst institutions and their insurers have been paying claims for abuse of children for some time, the Royal Commission is likely to lead to a radical change to the claims environment, both for claims for past abuse and for claims for future abuse.

These changes could lead to a substantial increase in future claim payments for institutions compared to current payment levels, although under certain circumstances discussed below might lead to a decrease in future claim payments. In turn, this may lead to changes in the payments made by insurers of affected insurers.
Whilst it is certain that there will be changes, the actual outcome, particularly for individual institutions and insurers, is highly uncertain at this time.

2.7 Potential changes driven by the Royal Commission

Below, I discuss some of the potential changes to the liabilities of institutions and insurers directly and indirectly due to the Royal Commission. Some of these changes are very likely, and have already been flagged by the Royal Commission. Other changes are speculative and necessarily subjective.

Institutions are under a civil, legal and perhaps moral obligation to make payments to victims of abuse. Insurers are under contractual obligation to make payments to policyholders.

Part of the uncertainty for insurers (and reinsurers) is that they lie at the end of a chain of connections: Firstly, the Royal Commission will likely impact victims and their advisors; in turn the victims (and the Royal Commission) will likely impact institutions and governments; the institutions will impact their insurers; and lastly insurers actions will impact reinsurers. Each step in the process is relevant and needs to be considered carefully.

2.7.1 The Royal Commission will investigate widely

The Royal Commission has already identified allegations of child sexual abuse in over 1,000 institutions, although it does not expect to investigate all of them (Royal Commission, June 2014).

These investigations may give rise to increased financial compensation and care and support costs payable by churches, governments, charitable organisations, private schools, sports clubs and other Institutions involving children. In turn, this may give rise to additional claims against insurers that
provided liability cover to such institutions. However, there are significant obstacles to successful claims as discussed below.

2.7.2 The Royal Commission will improve understanding of the incidence and prevalence of child sexual abuse in Australia

The Royal Commission has the power to compel organisations to provide it with information. As part of its systematic and wide-ranging investigations, the Royal Commission will build up a much deeper understanding than in the past of the extent to which abuse took place, the number of children abused, the number of offenders, and the number of institutions affected.

Currently, there are no reliable and comprehensive statistics on the incidence and prevalence of child sexual abuse in institutions in Australia. Through its own research and publications, the Commission is already providing insights into the nature and prevalence of child sexual abuse in institutions. For instance, Appendix C of Volume 1 of the Royal Commission’s interim report (Royal Commission, June 2014) contains statistics based on the private sessions it has conducted, including:

- 90 per cent of perpetrators were male
- On average, female victims were nine years old and male victims 10 years old when the abuse started
- On average, it took victims 22 years to disclose the abuse, men longer than women.
- 95% of survivors had previously disclosed their abuse, and 5% reported their abuse for the first time at the Royal Commission.

The Royal Commission has already completed 21 research projects and is scoping more than 30 additional projects. Two future research projects are on the “Prevalence and incidence of child sexual abuse in institutions in Australia”, which are likely to be useful in understanding the implications for insurers.

2.7.3 The Royal Commission will likely increase reporting of child sexual abuse

Lack of reporting
Most of the victims of sexual abuse do not disclose their abuse to authorities, nor do they take legal action against their offenders. It is here that the Royal Commission may have the greatest impact in increasing reporting rates and the willingness of victims to seek redress from offenders and the institutions where the abuse occurred.

Reporting delays
As noted above, 5% of survivors approaching the Royal Commission had not previously disclosed their abuse, suggesting a potential increase of at least 5% in reports. However, this likely understates the potential increase in reports as:
• While victims may have previously disclosed abuse, in many cases they were dissuaded from taking the matter further and many have reported that they were not believed by the authority to whom they disclosed the abuse. They may now have the confidence that they will be believed and pursue compensation;

• Victims who have not previously disclosed their abuse may take longer to come forward to the Royal Commission; and

• The Royal Commission does not have the power to award any compensation, and the prospect of compensation may further increase the reporting rate.

2.7.4 The Royal Commission will increase the prospect of claims against institutions for past abuse

Duty of care

To establish a claim against an institution, a victim would have to show that the institution was sufficiently aware of the potential risk, and failed to act appropriately, or acted inappropriately. By specifically investigating institutional responses, the Royal Commission could well establish that institutions failed to respond appropriately. Further, by bringing together victims of the same perpetrator, the Royal Commission could also establish that an institution should have known about the risk of abuse because of previous allegations and hence establish a duty of care for the institution. By legally establishing such a duty of care, claimants could then argue that the institution failed to act appropriately.

Further discussion of duty of care issues can be found in (Moran, Nichols, & Konstantinidis, 2005, pp. 5-6).

Limitation periods

Limitation periods theoretically reduce the ability of victims to bring complaints for past abuse. Different limitation periods apply for each jurisdiction in Australia. These can vary if the claimant was a minor at the time of the alleged incident. Some jurisdictions allow extensions of the limitation period, particularly for minors.

There are some further complexities that may extend the window for historical claims. There has been significant academic discussion surrounding the psychological barriers to victims of abuse commencing claims before the limitation period expires (Astbury, 2013).

Thus, while it may seem that many abuse claims may be subject to limitation periods, the extent to which this actually occurs is uncertain. In practice, institutions and insurers would be more likely to enter into commercial settlement for any claims, irrespective of limitation periods.

Further, the Royal Commission is specifically investigating the extent to which limitation periods are reducing access to justice for victims, and may recommend changes to existing limitation period laws.
Reopening prior claims

Prior claims might be reactivated where the Royal Commission uncovers additional evidence of abuse, or opens up additional avenues for compensation of victims.

2.7.5 The Royal Commission will increase the prospect of claims against insurers of institutions, although there will be significant barriers to such claims

To the extent that institutions had insurance cover that responds to claims, their insurers (and in turn their reinsurers) will face the prospect of increased claims.

Barriers to claims against insurers

However, even where institutions are found liable for sexual abuse, there are significant hurdles to successful claims against their insurers, including:

- Common policy exclusions regarding illegal or dishonest conduct and specific exclusions for molestation mean that insurers are unlikely to indemnify perpetrators of sexual abuse for the consequences of their conduct
- Identifying the policy and the relevant insurer at the time of the abuse
- Establishing whether that insurer still operates or if the liability for past claims has been transferred to another entity
- If the institution had elected to deal with the allegations in-house, and not referred the matter to their insurer, then issues of prejudice may arise
- Policy references to an accident (being an outcome not expected or intended by the insured) may extend cover to an institution, but not to an offender
- Occurrence may be undefined or lack clarity regarding aggregation of claims, particularly where the offender is a serial abuser
- Potential exclusions such as professional duty and exemplary damages may apply
- There may be coverage disputes where there is evidence that the institution knew of the abuse and did not take steps to stop it
- Some insurers may have only provided very low policy limits.

2.7.6 The Royal Commission may increase the prospect of class actions

The Royal Commission has brought together victims of abuse who are now able to form class actions against institutions that the Royal Commission concludes had insufficient or inappropriate responses.
Specifically, groups of victims that were previously unaware of each other are likely to be able to join together in class actions against specific perpetrators and institutions.

Litigation funders have already indicated that they are researching the potential for funding such class actions.

2.7.7 The Royal Commission may change the average payments made by institutions and insurers

Low historical settlements

Historically, most abuse claims were settled for relatively small amounts. In many cases the victims were not motivated to seek a financial reward and would rather settle out-of-court and receive an acknowledgement and apology for the abuse (Minister of Public Works and Government Services, 2000). Some institutions have also aggressively defended claims, which may also have discouraged victims to seek recompense – for example in the case of the Roman Catholic Church v Ellis (2007) 70 NSWLR 565. Further, economic loss can be extremely difficult to establish in the absence of physical injury. Most court awards arise under general damages (pain and suffering), which tend to be much less than those for economic loss.

Almost all were settled out of court. There are also suggestions that insurers provided very low limits of cover, and in such cases institutions and claimants may have been motivated to settle within those low limits.

(Moran, Nichols, & Konstantinidis, 2005) discuss one claim that did reach judgement in a trial. The court found that the plaintiff had “suffered loss and awarded compensatory damages of $415,000 and a further $400,000 in exemplary damages. The jury was not required to itemize damages, but did indicate that it had awarded $80,000 for pain and suffering, $14,000 for past economic loss and $10,873 for out of pocket expenses.”

Past redress payments from inquiries

Past inquiries into abuse at state institutions in Queensland, Western Australia and Tasmania have led to redress payments to claimants ranging between $7,000 and $80,000 each (Bravehearts, 2014).

Redress payments by churches

The Catholic Archdiocese of Melbourne currently awards up to $75,000 in compensation payments to victims (Hart, 2014). The Royal Commission has found that the Catholic Church in Australia has paid over $43m to claimants since 1997, but does not comment on the number of claimants or the average claim amount (Royal Commission, June 2014).

Redress payments in Ireland

As noted above the Residential Institutions Redress Board in Ireland has awarded on average €62,496 to each victim. To 30 September 2014 there have been 16,603 cases processed, with an average award of €62,204, and the largest award being €300,500 (Residential Institutions Redress Board, 2014).

Figure 1 Number of redress awards by band, Residential Institutions Redress Board

Legal costs

Insurers may pursue quick commercial out-of-court settlements in order to avoid adverse publicity and minimise legal costs. Alternatively, where class actions have been established, there may be substantial legal costs involved.

Potential changes

While the historical average cost of abuse claims may be relatively low, the Royal Commission’s inquiry into the efficacy of civil litigation in providing redress could also lead to an increase in future settlements. The Royal Commission has already established substantial evidence that the impact on victims of child sexual abuse can be lifelong and devastating. This may well have implications for the cost of care and support to victims, and consequently increase the cost of settlements.

Separately, the Royal Commission may establish a redress scheme, which might make redress payments at a higher level compared to past payments made under civil litigation.
Higher awards may stimulate legal activity

To date, the small size of awards, together with potential aggregation issues, has limited the potential compensation, and discouraged legal activity. However, should awards increase as a result of the recommendations of the Royal Commission, then this may stimulate legal firms to pursue compensation on behalf of victims. Litigation funding may also stimulate claims activity.

2.7.8 The Royal Commission may recommend increased access to justice and financial compensation for victims

The Royal Commission has released an issues paper examining the scope for justice for victims, including the question of financial compensation. It has also invited submissions on whether current civil litigation provides an effective form of redress or whether alternatives, such as a redress scheme similar to that established in Ireland, are required.

The Royal Commission expects to produce a report in mid-2015 recommending changes to civil litigation to improve access to justice for victims. As noted in the interim report, such changes might include:

- Establishing a redress scheme for victims
- Making institutions vicariously liable for the actions of their staff
- Requiring institutions to incorporate and hold insurance, so that a funded entity can be sued in the case of abuse3
- Removing limitation periods for claims involving child abuse, and
- Moving to an inquisitorial rather than an adversarial legal system.

These changes, designed to improve access to compensation for victims, could have a significant impact on the liability of insurers, particularly if the requirements for bringing a class action are reduced, or if a redress scheme is established.

2.7.9 The Royal Commission may establish a redress scheme

The redress scheme issues paper considers the scope, eligibility (e.g. past claims and/or future claims), standards of proof, and funding arrangements for a redress scheme, including whether it should replace civil litigation, or run in conjunction.

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3 In 2007 the NSW Court of appeal found that the Roman Catholic Church could not be held legally liable for abuse cases because the Church does not exist as a legal entity (Trustees of the Roman Catholic Church v Ellis (2007) 70 NSWLR 565).
Impact on insurers

Any redress scheme would also have a significant impact on the liability of insurers. Ordinarily, insurance policies would not respond to redress payments. However, insurers could be asked to contribute to the funding of a redress scheme in return for extinguishing their liability to institutions for such claims. Such a contribution would be difficult to estimate, due to the widely varying exposures and policy conditions of each insurer, which have also changed over time. Nonetheless, insurers may agree to a commercial settlement. Such an arrangement would substantially reduce the uncertainty of past claims, as well bring positive publicity from assisting victims.

It is worth noting that the Royal Commission has wide powers to compel insurers (and indeed generally) to provide information, including historical information such as institutions insured, coverage provided, claims settled, and amounts paid.

Redress payments may fund civil litigation

If any redress scheme established by the Royal Commission is to run in parallel with, rather than replace, civil litigation, then potentially victims could use the proceeds of any redress payment from the scheme to fund civil litigation against institutions. This could lead to a substantial increase in liability for both institutions and insurers.

Actuaries Institute Working Group

A working group of the Actuaries Institute recently provided input to the Royal Commission on factors to consider when setting up a redress scheme. This submission was based on actuaries’ extensive experience with:

- accident compensation schemes and victims of crime compensation schemes
- civil litigation and statutory schemes
- addressing issues of equity between stakeholders
- funding models and efficient scheme design.

The working group referred extensively to the recent models of the National Disability Insurance Scheme and the National Injury Insurance Scheme.

2.7.10 The Royal Commission will change future underwriting

The Royal Commission expects to issue recommendations designed to reduce the incidence of abuse, by identifying risk factors and recommending policies and procedures for institutions. This may well lead to lower claims incidence in future, and would have implications for future underwriting. Future underwriting might also be affected by any changes to limitation periods, changes in the duty of care of institutions, whether any redress scheme extends to future claims, and whether or not religious organisations may be forced to incorporate so that claims can be brought against them.
In considering changes to the legal framework, the Royal Commission has been conscious of not producing an environment where insurance is not available, and institutions cease to operate as they are unable to bear the financial risk of claims.

Chapter 10 of (Moran, Nichols, & Konstantinidis, 2005) discusses underwriting of molestation cover, and associated risk management practices.
3. Estimating liabilities for Insurers

3.1 What liability?

Consideration needs to be given to exactly what liability is being estimated and for what purpose. Some examples that may need to be considered are:

- What abuse claims are being estimated – all abuse or just sexual abuse?
- Estimating the liability in respect of past incidents for the purpose of establishing a provision under accounting standard AASB 1023 for outstanding claims for an insurer, at a given probability of adequacy
- Estimating the liability in respect of past incidents for the purpose of establishing a provision or a contingent liability under AASB 137 for outstanding claims for an institution
- Estimating the liability in respect of future reports of past incidents for the purpose of estimating premiums for claims made coverage
- Estimating the liability in respect of past incidents for the purpose of estimating premiums for run-off cover

3.2 Accounting and professional standards

In each case the actuary will need to give detailed consideration to the relevant accounting standard and professional standards. Compared to the usual uncertainties involved in the estimation of future claim payments, there are five significant sources of uncertainty in estimating an insurer’s liability for child sexual abuse claims:

- The exposure data relating to an individual insurer’s policy and coverage of institutions
- The exposure data relating to the number of potential offenders and exposed children in individual institutions
- The past prevalence of offenders and victims in institutions
- The reporting rate of victims, and how this might change due to the actions of the Royal Commission
- The average claim size, and how this might change due to the actions of the Royal Commission, including the introduction of redress schemes
- The impact of any redress schemes on both institutions and insurers

In fact, there is a real question in the short term on whether or not liabilities for child sexual abuse claims in institutions can be reliably estimated at all. Further any reasonable allowance for the uncertainty in the claims estimate may exceed the resources of many institutions in the short term, but in the longer term these uncertainties will be substantially reduced by the decisions of the Royal Commission. Thus we may be in the situation where a liability including
a risk margin for an institution may increase in the short term, but decrease in the longer term.

I do not consider these issues further here. (Atkins, 2014) discusses them further together with some potential approaches for actuaries in the short term.

3.3 Methods

As discussed in section 2.7, the Royal Commission is likely to lead to a step change in the reporting of child sexual abuse claims, as well as potential changes in liability and historical claim amounts.

Actuarial methods based on the extrapolation of past claims experience, will not necessarily be suitable for projecting claims liabilities, without significant adjustment for potential changes due to the Royal Commission. In such cases, methods based on exposure information may be more appropriate, and these are discussed in section 3.4.

Depending on the availability of historical claims information and exposure information, insurers will fall into one of three groups.

**Insurers with large exposures, and a large number of historical claims.** are more likely to make substantial use of their historical claims information, supplemented by a broad consideration of exposure information. Such insurers are likely to include captives of religious organisations, schools, governments, and other specialist insurers.

**Insurers without a large number of historical claims, but with a material amount of exposure information** are likely to undertake exposure based analyses, supplemented with reasonableness tests based on historical claims information. Such insurers are likely to include companies that provided professional indemnity and public liability coverage to sports clubs and other organisations with some exposure to children.

**Insurers without a large number of historical claims and without a means to estimate exposure** will likely require approximate and subjective assessments. Fortunately, the lack of historical claims suggests that such insurers are unlikely to have significant exposures to child sexual abuse claims, and so such approximate allowances might well be justified on the grounds of lack of materiality.

3.4 Exposure based methods

3.4.1 Similarities to US asbestos and pollutions liabilities

Exposure based methods were widely used in the estimation of asbestos and pollution liabilities in the United States during the late twentieth century. There were substantial similarities compared to estimating liabilities for child sexual abuse as:

- Liabilities were triggered through a number of asbestos producers and a number of environmental sites. For child sexual abuse, liabilities will be
triggered by the failure of institutions to provide adequate protection to children in their care.

- There are substantial delays between the events giving rise to the liability and the reporting of liabilities, mainly due to the latency period for asbestos related diseases. Similar lengthy delays are expected between the incidences and reporting of child sexual abuse.

- External events lead to the recognition of a liability, when a liability was not anticipated at the time of the insurance coverage. For example Superfund and other federal legislation that required companies to remediate sites from the effect of historical pollution. The Royal Commission plays a similar role in surfacing the liability for child sexual abuse. Further, what may have been seen at the time as being acceptable standards and duty of care, with the benefit of hindsight and changing society requirements was not sufficient. This means insurance cover did not anticipate these types of events, and can be insufficient.

- Insurers did not provide full coverage for the liabilities of institutions for pollution or asbestos liabilities. Similarly, insurers may not be liable for the total liability of institutions to victims of child sexual abuse. The liability for insurers will vary substantially depending on the nature of the coverage provided.

- Historical insurance coverage information may not be available to both companies and insurers. Even where insurance policies can be identified, the relevant insurer may no longer exist.

Thus whilst the particular circumstances of the liabilities are very different between US asbestos and pollution liabilities and Australian institutional child sexual abuse liabilities, similar actuarial approaches may still prove useful.

One of the most detailed exposure based analysis of US Asbestos liabilities was in the case of the Johns-Manville Corporation that produced approximately 25-40% of US fire-resistant asbestos roofing material (Stallard, Manton, & Cohen, 2004). This book covers a variety of models to estimate the number of asbestos claims, and estimate the liability. Whilst some of the details are specific to asbestos, the general framework and approach is relevant for child sexual abuse claims.
3.4.2 Framework

Figure 3.1 – Exposure based framework

An exposure based analysis for estimating the cost of an insurer’s liability for child sexual abuse claims from institutions consists of the following general steps:

- Identify relevant institutions insured by the insurer, allow for the survival rate of the institution to the current date, and for each institution:
  - Identify the number of **victims** of child sexual abuse by:
    - Either identifying or estimating the number of **potential offenders**, multiplying by an assumed **offender rate** and by an assumed number of **victims per offender**
    - Or identifying or estimating the number of **potential victims** and multiplying by an assumed **victim rate**
  - Estimate the number of **future reported claims** by allowing for:
    - A **reporting rate**, to estimate the number of victims who report abuse to the institution in pursuit of compensation
    - Any **past reports** to the institution, the observed delay between exposure and actual reported claims, or the impact of any redress scheme
- Apply the impact of any **insurance coverage** and limitations to estimate the number of claims payable by the insurer
- Estimate the **average size of claims**
- Combine the average size of claims with numbers of future claims reported to estimate the liability of the insurer to the institution
• Combine across institutions to estimate the total liability for the insurer

### 3.4.3 Critical assumptions

#### Definitions

The above framework consists of a combination of exposure data and critical assumptions. These critical assumptions including the following:

\[
\begin{align*}
\text{Offender rate} &= \frac{\text{Number of paedophiles}}{\text{Number of potential offenders}} \\
\text{Victim rate} &= \frac{\text{Number of victims of child sexual abuse}}{\text{Number of children}} \\
\text{Victims per offender} &= \frac{\text{Number of victims of child sexual abuse}}{\text{Number of paedophiles}} \\
\text{Reporting rate} &= \frac{\text{Number of victims who seek financial compensation from the institution}}{\text{Number of victims}} \\
\text{Average size of claims} &= \frac{\text{Value of financial and other compensation paid to victims}}{\text{Number of victims reporting abuse to the institution}}
\end{align*}
\]

#### Estimation

In order to estimate these assumptions, the actuary will need to refer to and assess various sources. As noted in section 2.7.2, there are currently no reliable and comprehensive statistics on the incidence and prevalence of child sexual abuse in institutions in Australia, although the Royal Commission is already improving the research into this area. The interim report (Royal Commission, June 2014) includes a discussion of the potential sources of information that can be reviewed, as well as providing detailed statistics on the Royal Commission’s own experience. Other sources of useful statistics include reports published by charities (Ronken & Johnston, 2012).

The Royal Commission has indicated that it may make further information available, and any such disclosure of the statistics of abuse in institutions will greatly improve the ability of actuaries to estimate these critical assumptions. Further many of these assumptions will depend on the recommendations and actions taken by the Royal Commission over the next two years. In the interim, I suggest that a scenario based approach be used as discussed in Section 4 below.

Chapter 8 of (Moran, Nichols, & Konstantinidis, 2005) discusses claim rates, including incidence rates, victims per offender, and offender characteristics. Section 9.4 also discusses report delays and average ages, settlement costs, and gender splits for an unpublished Australian data sample. The paper suggests an underlying insured sexual molestation rate of the order of 2% of children historically, but notes that current risk management practices are likely to lead to a significantly lower rate in future.
3.4.4 *Specific considerations*

**Relevant data**

The major difficulty with previously available data, such as the Australian Bureau of Statistics’ crime surveys (Australian Bureau of Statistics, 2012), is that they may exclude children, are either not specific to institutions, or may exclude institutions altogether.

Reported crime statistics are unlikely to be reliable as the evidence suggests that a substantial proportion of abuses go unreported. Further the rate of reporting may not have been constant over time.

**Risk factors for critical assumptions**

One of the main unknowns at this time is the extent to which the offender and victim rates may differ depending on the institution. For example, these may vary by:

- Religious institution, government institutions or other non-religious institutions
- by type of sport, for sports clubs
- residential and non-residential intuitions
- Mix of professional staff and volunteers
- Mix of gender in both adults and children

Certainly, the interim report provides evidence that reporting rates, offender and victim rates vary by sex, as well as by type of institution (Royal Commission, June 2014).

This is likely to be one area where additional information and research from the Royal Commission will improve the estimation of liabilities. In the meantime, actuaries may be forced to use assumptions that do not vary by type of institution.

**Numbers of victims**

There are two potential approaches to establishing the number of victims of abuse for each institution: either quantify the number of children exposed, estimate the prevalence of abuse, and deduce the number of abused children; or quantify the number of adults working in the institution, estimate the offender rate and average number of victims per offender, and deduce the number of abused children.

There are advantages to following both approaches in order to have a sense check on the results. Further, some insurance may be limited by the number of offenders, and hence require this to be modelled explicitly.
Reporting rates

The existing evidence and literature shows that most of the victims of sexual abuse do not disclose their abuse to authorities, nor do they take legal action against their offenders.

The Royal Commission may increase reporting rates by increasing the willingness of victims to seek redress from offenders and the institutions where the abuse occurred.

Historical statistics derived in a similar way to victim and offender rates will need to be adjusted to allow for the impact of the Royal Commission.

3.4.5 Exposure data

The first stage of the analysis – identifying insured institutions, and the number of children exposed, or the number of potential offenders – will depend critically on the quality of any historical information available to the insurer. In many cases, these records may not exist at all.

For example, (Moran, Nichols, & Konstantinidis, 2005, p. 7) conducted a portfolio review of a moderately sized liability insurer identifying 65,000 references to children, and approximately 3,000 credible child risk exposures. This highlights the difficulties, and the potential for errors, in identifying exposure through reviewing past policy information.

Where no detailed information exists, market share could be used to estimate exposure. Alternatively, where the occupation group of insureds was recorded, an attempt might be made to establish the proportion of each occupation group that was insured.

Part of the Royal Commission’s work has been to establish a record of institutions, perpetrators and victims. The Royal Commission has stated that where necessary it will share information relevant to law enforcement and children presently at risk.

3.4.6 Insurance coverage

Common policy exclusions against illegal or dishonest conduct and specific exclusions against molestation mean that insurers are unlikely to indemnify perpetrators of sexual abuse for the consequences of their conduct. However, where a perpetrator was employed by an institution, a claim could be brought against the institution under certain circumstances.

To establish a claim against the institution, a victim would have to show that the institution was sufficiently aware of the potential risk, and failed to act appropriately, or acted inappropriately. By specifically investigating institutional responses, the Royal Commission could well establish that institutions failed to respond appropriately. Further, by bringing together victims of the same perpetrator, the Royal Commission could also establish that an institution should have known about the risk of abuse because of previous allegations and hence establish a duty of care for the institution. By
legally establishing such a duty of care, claimants could then argue that the institution failed to act appropriately.

As noted in section 2.7.4, there are significant barriers to a successful claim against an insurer for any compensation paid by the institution. Where there are limitations to any cover provided – for example due to policy limits, or the introduction of exclusions at certain dates – these can be incorporated in the exposure analysis where possible.

Policy conditions

Chapter 10 of (Moran, Nichols, & Konstantinidis, 2005) discusses a survey of six underwriters that provided coverage to children, including some cases of cover for molestation claims. Notably, most insurers imposed a deductible of $50,000, and the limit of indemnity was either an aggregate or limited to $3M, substantially less than typical indemnity limits of $10M, $20M or $50M.

3.5 Claims based methods

As noted above, some insurers have a substantial body of historical claims, together with detailed exposure information. This information would allow the application of methods based on reported claims information, although as noted above, some allowance will be needed for the impact of the Royal Commission in adjusting historical rates.

Historical data can be used to estimate the reporting delay between the date of incident (or first incident) allowing also for cohorts of victims by date of birth. Allowances would need to be made for:

- Changing patterns in reporting delays over time due to a greater willingness of victims to come forward, and
- Changing incidence of sexual abuse due to changes made by institutions to reduce the incidence of abuse over time.

These adjusted reported rates can then be applied to exposure information in order to estimate the number of incurred but not reported claims. Thereafter a similar allowance for average claim size to the exposure based method can be applied.

This approach is similar to what is used for estimating liabilities for asbestos related diseases which have a long reporting delay. However, a key difference is that for asbestos related diseases, the delay in reporting is substantially due to the latency period for the disease, which is generally assumed to be constant over time, whereas for child sexual abuse claims, reporting delays are likely to vary over time.
4. Scenario testing the impact of the Royal Commission

4.1 Purpose

There are two main related reasons for considering scenario tests:

- To illustrate the high levels of uncertainty associated with the critical assumptions, and their impact on the estimates of liability
- To establish provisions at different probabilities of adequacy.

4.1.1 Illustration of uncertainty

As noted in (Atkins, 2014), careful consideration will need to be given on the extent to which any estimates include the impact of the Royal Commission, given the uncertainty of both the final recommendations, and the consequent action taken by governments. (Atkins, 2014) argues that until these uncertainties are resolved, no allowance should be made within the estimates of the liability included in financial statements and regulatory returns.

However, for internal purposes, many insurers may wish to investigate the range of potential outcomes under the various impacts that the Royal Commission may have. These may be included within Financial Condition Reports for APRA regulated insurers.

4.1.2 Probability of adequacy

Since the distributional properties of the assumptions are unlikely to be known, a scenario approach is possibly the only practical method of considering provisions at different probabilities of adequacy.

When considering a scenario that targets an overall probability of adequacy in the valuation estimate, care must be taken not to overstate the overall variability as the parameter uncertainty in each individual assumption will in effect “multiply up” through the valuation model.

In any case, targeting a probability of adequacy is extremely difficult. There are extreme levels of uncertainty in any estimate of the liability, due to:

- Independent risk – including parameter error and process error
- Internal systemic risk – including data error, model specification error, and parameter selection error
- External systemic risk – the most significant of which is the impact of the Royal Commission, and any governmental response to the Royal Commission

Care must be taken in explaining these uncertainties, so that Boards and other stakeholders are adequately informed about the nature of the estimates, and do not take too much comfort in the estimation of the liability.
In this section I consider some of the scenario tests that might be considered.

4.2 **Offender and victim rates**

Underlying offender and victim rates are difficult to estimate primarily because so many abuses are not reported, or are reported after significant delays. In particular, current estimates of underlying prevalence rates may be understated because of historical reporting delays. Additionally, the reported abuse may not be specific about the type of abuse, and may include physical, emotional and sexual abuse in the numbers. Thus whilst the Royal Commission cannot affect the rate of past abuse, it can change our understanding of the prevalence of abuse.

As discussed in section 2.7.3, the Royal Commission may substantially increase reporting rates, which in turn may lead to changes in estimates of underlying offender and victim rates. Consequently scenario tests can be attempted to allow for changes in offender and victim rates.

4.3 **Reporting rates**

Reporting rates may substantially increase following the Royal Commission. Possible scenarios include:

- no change from historical patterns (where available)
- 5% increase in reporting
- 20% increase in reporting.

As noted in section 2.7.3, 5% of survivors approaching the Royal Commission had previously not disclosed their abuse, suggesting a scenario of a 5% reporting increase. However, this likely understates the potential increase in reports as discussed in section 2.7.3.

It is likely that any increase in the reporting rate from the Royal Commission is likely to be a one-off effect, so care must be taken not to project any increase in reporting rate too far into the future.

4.4 **Redress scheme**

As noted in section 2.7.9, the Royal Commission may establish a redress scheme.

Currently, salient features of any future scheme are unknown, including such factors as:

- The scope of the scheme – e.g. past incidents only, or also future incidents
- The “burden of proof” required by any claimants
- The benefits available, such as financial payments, care and support, and legal advice, as well as the amount of benefits available
• Who will run the scheme – e.g. institutions, state governments or a national scheme

• The funding of the scheme by institutions, governments, insurers and other parties, and whether on an up-front basis, or pay-as-you-go or other basis

• Whether claimants who have previously received compensation will be able to reclaim from the scheme, or if any previous payments would be deducted from the benefits available

• Whether or not claimants would be able to continue to pursue civil litigation as well as receiving benefits from the redress scheme

For insurers, the outcomes are particularly uncertain, including:

• Whether insurers will fund the redress scheme, how much funding they would provide, and whether this would be on an up-front basis (in return for extinguishing any liability) or on a per claim basis

• Whether civil litigation will continue to be an option, and whether the scheme would encourage further civil litigation, or reduce civil litigation by providing an alternative means of redress

Conceivably, the liability of insurers could either increase or decrease under a redress scheme, and both outcomes could be scenario tested.

4.5 Claim size

As noted in section 2.7.7, historical claim payments have been relatively small, but may increase due to the Royal Commission. In particular, a redress scheme might establish a minimum benefit to be awarded in civil litigation, and may also standardise benefits such as care and support.
5. Bibliography


