

10 June 2020

Committee Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
PO Box 6100  
Parliament House  
Canberra ACT 2600

By email: [corporations.joint@aph.gov.au](mailto:corporations.joint@aph.gov.au)

### **Inquiry into litigation funding and the regulation of the class action industry**

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia<sup>1</sup>. ICA members provide a range of general insurance products including public liability and professional indemnity insurance.

Thank you for the opportunity to provide a submission to the Parliamentary Joint Committee's inquiry.

The ICA previously provided a submission to the Australian Law Reform Commission's (ALRC) 2018 Inquiry into Class Action Proceedings and Third-Party Litigation Funders.<sup>2</sup> The ICA also provided a submission to the Victorian Law Reform Commission's 2017 review of Litigation Funding and Group Proceedings.<sup>3</sup> For the Committee's reference links to these submissions are footnoted below.

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<sup>1</sup> The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

<sup>2</sup> Insurance Council of Australia submission to the 2018 ALRC Inquiry into Class Actions Proceedings and Litigation Funding, 3 August, 2018. Available at:  
[https://www.insurancecouncil.com.au/assets/submission/2018/2018\\_08\\_03\\_Submission\\_ALRC%20Class%20Action%20Proceedings.pdf](https://www.insurancecouncil.com.au/assets/submission/2018/2018_08_03_Submission_ALRC%20Class%20Action%20Proceedings.pdf)

<sup>3</sup> Insurance Council of Australia submission to the Victorian Law Reform Commission 'Access to Justice - Litigation funding and group proceedings' 30 October, 2017 available at:  
[https://www.insurancecouncil.com.au/assets/submission/2017/October%202017/2017\\_10\\_10\\_VIC%20Law%20Reform%20Commission%20Access%20to%20Justice%20review%20of%20class%20a....pdf](https://www.insurancecouncil.com.au/assets/submission/2017/October%202017/2017_10_10_VIC%20Law%20Reform%20Commission%20Access%20to%20Justice%20review%20of%20class%20a....pdf)

The ICA reiterates the key points made in these submissions, in particular:

- For the class action regime in Australia to remain legitimate class members must receive an appropriate and reasonable proportion of any settlement/judgment amount.
- The insurance industry's support for the introduction of a licensing regime for litigation funders operating in Australia.
- The need for reform of the class action regime address the inefficiencies and unnecessary expense caused by competing closed class actions.
- The introduction of a more robust certification process and increasing the existing threshold criteria to commence a class action to address issues impacting both class members, defendants to class action proceedings and the judicial system more broadly.
- The impact the continuous disclosure obligations and securities class actions continue to have on the availability and affordability of Directors & Officers (D&O) insurance in Australia (particularly for smaller publicly listed companies).
- Support for the ALRC's recommendation 24 that there be a separate review into the legal and economic impacts of the continuous disclosure obligations of the *Corporations Act (2001)* and the *ASIC Act (2001)*.

The ICA welcomes the Federal Government's recent announcement that litigation funders will soon be required to hold an Australian financial services licence and comply with the managed investment scheme regime.

Nonetheless many of the shortcomings and inefficiencies of Australia's class action regime identified by the ALRC's final report remain to be addressed.

**Factors driving class actions proceedings in Australia – Litigation funding and the continuous disclosure regime.**

As outlined in the ICA's submission to the ALRC, the biggest single factor driving the increase in class actions in Australia has been the surge in securities class actions (shareholder class actions) backed by litigation funders. These actions are based on company directors' alleged breach of the continuous disclosure obligations under the Corporations Act and ASIC Act.

Actions against company directors based on breach of these continuous disclosure obligations are exceedingly difficult to defend, as a breach of these obligations can arise from an honest mistake as opposed to any deliberate intention to withhold information, so essentially apply a strict liability on directors.

Not surprisingly, the onerous and strict application of the continuous disclosure obligations on company directors along with the liberal class action regime has seen Australia become a highly attractive and profitable market for litigation funders. In fact, Australia now has the second biggest litigation funding market, second only to the United States<sup>4</sup> and is the most likely jurisdiction outside of the United States in which a company may face significant class action litigation.<sup>5</sup>

This is reflected in the number of securities class actions commenced in Australia in recent years.

For example, in the period from 2010-2016 there were 42 new securities class actions filed in Australia, compared to just 13 securities class actions being filed in the previous 6 years.<sup>6</sup> The average settlement amount for these actions was approximately \$50 million, with some settling for over \$100 million.<sup>7</sup> By comparison the Australian Directors & Officers insurance premium pool around this time was comparatively small at approximately \$280 million.

### **The economic impact of securities class actions**

One consequence of the continuous disclosure obligations and the ongoing and increasing securities class action litigation funding activity in Australia has been the unprecedented increase in the cost of Directors & Officers insurance in Australia, in particular Directors & Officers 'Side C' insurance for publicly listed companies. Side C insurance provides cover to companies for securities or shareholder claims brought against them.

While securities actions are increasing worldwide, the United States and Australia continue to see the highest activity as well as having the most developed securities class action mechanisms.<sup>8</sup> Therefore Australia has become a 'high risk' region for securities class actions.

The high risk involved in providing D&O side C insurance coverage in Australia is reflected in the statistics and commentary on the current status of the Directors & Officers insurance market in Australia.

To cater for the increased insurance underwriting risk, Directors & Officers insurance premiums in the past 7 years in Australia have risen, on average, by 250%. More recently,

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<sup>4</sup> Allianz Global Corporate & Specialty, Insights @ AGCS – Director and Officers Insurance Insights 2020, November 2019; p. 5.

<sup>5</sup> Allens, Shareholder Class Actions in Australia, February 2017.

<sup>6</sup> XL Catlin and Wotton & Kearney White Paper, *How did we get here The history and development of securities class actions in Australia*; May 2017; p. 9.

<sup>7</sup> 'Securities Class Actions Causing Distress'; *Insurance Business*; Issue 6.3 (2017); p. 38.

<sup>8</sup> Allianz Global Corporate & Specialty, Insights @ AGCS – Director and Officers Insurance Insights 2020, November 2019; p. 5.

the first three quarters of 2019 saw Directors & Officers premiums rise by 75% on average. This increase was on top of an 88% average increase in 2018.<sup>9</sup>

The increasing trend in the number of securities class actions in Australia is expected to continue.<sup>10</sup> Therefore, despite these significant premium increases that have already taken place, insurers forecast that the Directors & Officers Insurance market, in particular the Side C D&O market, will continue to deteriorate and harden in line with insurers continuing to leave this section of the market or reducing their side C insurance risk appetite.

This will continue to have significant ramifications for Australian publicly listed companies' ability to both source and afford D&O side C insurance coverage. In particular, smaller ASX listed companies will continue to experience more and more difficulty obtaining side C insurance at an affordable price.<sup>11</sup> For some companies this may ultimately force them to decide not to renew or significantly reduce their D&O side C insurance cover.

The high prevalence of class action activity in Australia will continue to have a broader economic impact on Australian businesses and companies. Being a high-risk class action target Australian companies need to focus greater resources to responding to and managing litigation compared to non-ASX listed companies that are not subject to the Australian continuous disclosure obligations.

It is within this context that the ICA reiterates its support for the ALRC's recommendation 24 that there be a separate review into the legal and economic impacts of the continuous disclosure obligations of the *Corporations Act (2001)* and the *ASIC Act (2001)*.

We trust the Committee will find the information included in this submission useful.

If you have any queries please contact Tom Lunn, Senior Policy Manager on (02) 9253 5122 or via email [tlunn@insurancecouncil.com.au](mailto:tlunn@insurancecouncil.com.au).

We look forward to the inquiry progressing and the release of the Committee's final report in December.

Yours sincerely



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Executive Director & CEO

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<sup>9</sup> Marsh JLT Specialty; *The D&O Insurance Wave: Staying Above Water*; December 2019; p. 1.

<sup>10</sup> Ibid. p. 19.

<sup>11</sup> Aon, *Directors & Officers Insurance Market Insights – Q1 2019*.