ECONOMY, ENERGY AND FAIR WORK COMMITTEE
BUSINESS SUPPORT INQUIRY
SUBMISSION FROM Clyde & Co

Damages (Investment Returns and Periodical Payments) (Scotland) Bill

We have engaged with the ABI to assist with informing their response to the Consultation. Unless otherwise specified, we agree with and adopt the response of the ABI. This response seeks to supplement the response of the ABI.

General

1. What are your views on the Bill overall? Is legislation in this area required? How far do you think the Bill will achieve what it sets out to do?

We welcome the Scottish Government's proposals to change the method for setting the discount rate, which should improve transparency and lead to a fairer and more stable method for setting the rate going forward.

The proposals are a significant improvement on previous reliance on ILGS and supposed 'risk free' investment strategy which was flawed and unworkable, particularly as rates of return and the economic environment changed subsequent to the Wells v Wells decision in 1999.

The current framework has led to a wholly theoretical rate which does not reflect the investment practice of pursuers and therefore leads to significant over-compensation, as found by the Government Actuary Department (GAD) (thus undermining the principle of full compensation).

The principle of 100% compensation must be central to any change in the law. However, this requires a legal framework which facilitates the delivery of full compensation, neither under- nor over-compensating pursuers.

Evidence suggests pursuers invest in a mixed portfolio of assets. Such a diversified investment strategy should underpin the assumptions when setting the methodology for determining the rate, which it does to a certain extent. However the current content of the notional portfolio is presently too cautious and the additional adjustment, described in the Bill as the "further margin" is unnecessary and likely to result in overcompensation.

The legislation could go further to better consider how pursuers actually invest their damages in practice when setting the rate as a more accurate means of compensating victims. This would ensure the fairest framework for setting the rate and more readily
enable the 100% compensation principle to be achieved and prevent pursuers being under / over compensated.

The fixed three year period of review, whilst promoting certainty, may result in unwanted consequences as parties seek to 'game' the system ahead of any review. Given large loss cases typically take up to five years to resolve, there is likely to be the possibility that either a pursuer or compensator might seek to use a pending review to their advantage in the context of a settlement negotiation.

A longer review period of 5 years may prevent such 'gaming' tactics. However the frequency of review should lead to smaller changes in the discount rate and therefore a lower impact from any rate change. Ensuring consistency with the position in England & Wales would also be beneficial for stakeholders, many of whom work cross-border. Adopting the current 5 year review period in the Civil Liability Bill is therefore attractive.

**Part 1**

2. Part 1 of the Bill aims “to reform the law on the setting of the personal injury discount rate in order to make provision for a method and process which is clear, certain, fair, regular, transparent and credible”. Is it an aim with which you agree? And to what extent do you believe the reform will achieve all these things – a clear, certain, fair, regular, transparent and credible method and process?

We welcome the Scottish Government's aims to make provision for a method and process which is clear, certain, fair, regular, transparent and credible.

The methodology for setting the rate is prescriptive and clearly set out in the legislation. The requirement for the rate-assessor to publish the report at the point of review should operate to ensure transparency in the process and ensure the rate is justifiable by reference to the evidence provided to the rate-assessor.

However there are limitations to this approach. Mandating a 'national investment portfolio' is somewhat artificial and does not necessarily take into account the investment practices of pursuers. Indeed the notional portfolio is overly cautious and should contain a higher proportion of equity investments to ensure the 100% compensation principle is upheld.

It is not possible to determine that one particular mix of assets, however appropriate for now, will meet that risk profile in the future, especially when that future is decades away. Preventing flexibility by adhering too rigidly to an artificial notional portfolio could therefore operate to undermine the flexibility of the rate-assessor in setting a rate and undermine the 100% compensation principle.

The "further margin" provisions may also operate to undermine certainty and fairness in the process. No justification has been provided for not simply including these
considerations in the process for setting the rate. The notional portfolio is already too cautious and the "further margin" is likely to erode the 100% compensation principle still further.

3. In terms of who sets the rate, the Scottish Government proposes to have the rate reviewed by the Government Actuary rather than Scottish ministers (as is the current situation). It believes that this will remove the setting of the rate from the political sphere “where there is the potential for pressure from external interests to attempt to influence the outcome” and “should provide fairness to all parties involved”. What are your views?

Given the political sensitivities and accountability required in setting the new rate, we are of the view that authority should rest with the Scottish Government, to ensure that the decision on the rate remains a statutory one rather than one for judicial decision. This will provide the correct level of accountability and allow decisions to be challenged if required in a manner that is familiar to stakeholders.

The Bill does not appear to remove the setting of the rate from the political sphere; given specifying and altering the portfolio and "further margin" both rest with the Scottish Government. It is likely these requirements will need to be exercised before each review to ensure that underlying assumptions remain accurate. The assumptions made by Scottish Ministers will therefore considerably influence the outcome of the process.

4. The Scottish Government has chosen to lay down in detail how the rate should be calculated in legislation. Do you support this proposal over the approach taken in England and Wales of leaving much more to the discretion of the Lord Chancellor and an expert panel?

Given the vagaries in setting the rate and the need for flexibility in the approach depending on the prevailing economic conditions, as well as the need to fully consider actual investment practices of pursuers, the proposals fail to reflect the reality of the situation. The approach taken in England & Wales, whilst providing enhanced discretion to the decision makers, appears to better allow the 100% compensation principle to be adhered to.

The Scottish proposals are significantly less flexible than the approach in England & Wales. The Bill is much more prescriptive on the obligations and restrictions of the Government Actuary, who sets the rate. Whilst an expert panel has to be consulted in England & Wales there is no requirement in Scotland, although the Actuary will be aware of the expert evidence in practice. Given the views of the expert panel will be equally applicable in Scotland as the rest of the UK; consideration should be given to their use.
We agree with the ABI’s points concerning the drafting of the Bill which mean that the rate-setter’s discretion as to the final rate is very limited. In particular, the 30-year period is too low and too cautious and this is further exacerbated by the “further margin”, both of which significantly undermine the 100% compensation principle.

5. With no statutory requirement for the discount rate to be reviewed regularly, currently there can be a 15 year gap between reviews in Scotland. The Government Actuary will start a review of the rate on the date on which the relevant provisions of the Bill are brought into force. Thereafter they will be required to start a regular review every three years and the Scottish Ministers may decide on an additional, out-of-cycle review, but which would not disrupt three-yearly reviews. Do you have any views?

We welcome a regular review mechanism in order to promote certainty and prevent significant rate changes as occurred at the last review. Equally, it is beneficial to allow interim reviews to take place where changes in economic conditions require it, providing it is exercised sparingly and such reviews reset the fixed review period.

It is noted that the proposed three year review period seeks to represent a compromise between those calling for more frequent reviews and those who prefer a less frequent disruption to the handling of serious injury claims. However, given that catastrophic injury claims typically take 3 years to conclude, there is a risk that parties may try to ‘game’ the system in anticipation of a favourable change in the rate.

Accordingly, there is merit in extending the review period to 5 years. The House of Lords secured this amendment in relation to the discount rate provisions in England & Wales on the basis it would provide further certainty and not unduly impede flexibility in the process. Amending the Scottish provisions to ensure consistency would be welcomed.

6. In changing the methodology to move away from a rate based on Index-Linked Government Stock (ILGS), the Bill makes provision “on the basis of portfolios described as cautious and which we believe would meet the needs of an individual in the position of the hypothetical investor who is described in the legislation”. The Scottish Government also states: “The portfolio does reflect responses to the consultation that investing in a mixed portfolio of assets provides flexibility and is the best way of managing risk”. Do you think the Scottish Government is justified in assuming that injured people have access to the necessary expertise to achieve this?

This question is best answered by pursuers and their legal representatives.

We note the 2013 Ipsos Mori survey for the Ministry of Justice advised that pursuers received advice from both their solicitors and financial advisors who had been instructed by their solicitors.
Additionally in cases where the settlement needs approval, input from a financial advisor is mandatory. Indeed in all other cases, it is in the best interests of pursuers to be properly advised so we assume detailed advice must be provided by financial advisors as a matter of routine. Failure to do so would amount to professional negligence.

**Part 2**

7. Where damages for personal injury are payable, the Scottish courts may make a periodical payments order but only where both parties consent. This differs from England and Wales, where the courts have the power to impose such an order. Part 2 of the Bill will give courts the powers to impose periodical payments orders (PPO) for compensation for future financial loss. Respondents to recent consultations overwhelmingly supported courts in Scotland having the power to impose periodical payment orders, seeing this as a way of reducing uncertainty as well as the risk of over-/under-compensating pursuers. What is your position?

We agree there is merit in ensuring the provisions through the UK in relation to PPOs are consistent. It will mean that Courts can award a PPO where it is in the best interests of the pursuer.

The low uptake of PPOs, even in the period when the discount rate was set at 2.5%, demonstrates that most pursuers prefer a lump sum award and therefore to take some, albeit limited, investment risk, based on financial advice received.

The risk pursuers choose to accept is well above the "very low risk" theoretical construct. Part of the reason for choosing a lump sum may also be driven by other factors, such as the desire to leave a legacy for dependants. The important point to note is that this is an informed choice by the pursuer and this should not be unduly interfered with by the court.

The reality is that any pursuer opting for a lump sum award is taking a number of risks (inflation, longevity, investment risks) and will only do so in a high-value claim following receipt of independent financial and legal advice and, therefore, is making an informed choice to accept a lump sum. In the vast majority of cases such pursuer will also be advised about the availability and suitability of a periodical payments order (PPO).

The need for the "further margin" is further undermined by the availability of PPOs. The 0.5% margin is said to be included to avoid the risk of under-compensation. This is simply unnecessary given the investment portfolio approach is overly cautious and pursuers with the lowest risk appetite can utilise a PPO.
8. How well used do you think the provisions would be in practice? What impact do you think the requirement on the court to ensure the “continuity of payment under such an order would be reasonably secure” would have?

It is considered that further PPO take up under the new provisions will be limited. It is to be hoped courts do not seek to impose PPOs in the absence of demand from the parties. For example, a PPO is likely to be unacceptable to a pursuer where there is a significant reduction for contributory negligence, as the annual sum may be considered insufficient to cover the costs of ongoing care.

Additionally, a pursuer may refuse a PPO because they require certainty and closure from the settlement process and do not wish to maintain ties with the insurer. Succession planning for family members may also be a motivating factor for pursuers to favour a lump sum. Other pursuers may refuse a PPO for reasons to which only their lawyers and financial advisors are party to.

In their 2016 update report, the GIRO Working Party noted that the number of PPOs by settlement year has been falling steadily since 2012. It is not clear why the number of PPOs has fallen in recent years, although the fact that their use increased in 2009 and tailed off after 2012 could be linked to the financial crisis.

The use of PPOs will be driven by pursuer choice and they will decide, based on financial and legal advice, whether they would prefer to have a lump sum or a PPO. However, the correlation between the propensity for PPOs and turbulent investment markets in England & Wales would also suggest that pursuers are influenced by the external environment and how safe it is to invest their damages, as pursuers choices are driven by a longer term view of potential returns.

Continuity of payment requirements is unlikely to materially affect the take up and operation of PPOs, which seek to mirror those in England & Wales. The majority of compensators will be able to satisfy the requirements as seen in England & Wales, which the condition has not had an impact on PPO use.

We agree with the ABI's proposal that Scotland adopts an equivalent system to England & Wales, requiring settlement to be approved by the court for a valid discharge of the claim.

9. The proposals in the Bill would allow the courts to revisit a compensation award where there has been a change of circumstances (although only where this has been identified in advance). This would represent a change to the current law. Do you have any comments?

It will be important to ensure this provision is not abused. Whilst it will promote access to justice, care must be taken that it does not unduly undermine certainty in the litigation process which is important for all stakeholders.
This provision will need to be monitored in practice to see that it is not misused and there is no gaming of the system and the instances of satellite litigation on this issue do not disproportionately increase.

We support the ABI's proposed amendments to this provision.

Overall

10. The Bill overall is intended to support the Scottish Government’s national outcome that: “We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others”. Do you have any comment?

The impact on wider society, as payers of tax and insurance premiums, is an important part of the balance inherent in creating a fair mechanism for setting a discount rate which reflects actual investment practices of pursuers.

Without accurately reflecting actual investment practices, the discount rate will lead to significant over-compensation, which is currently the case, and therefore does not meet the 100% compensation principle.

The significant costs of over-compensation creates a problem for society at large, not just through pressure on insurance premiums for motorists and businesses but also for those public bodies who have to meet the cost of compensation, including the NHS.

11. In previous consultations in this area, views have tended to be polarised between pursuer and defender interests. Does the Bill, in your view, manage to balance these interests?

Whilst the Bill addresses many of the fundamental problems under the current system, more could be done to fully conform to the 100% compensation principle.

Improved consistency with the new provisions in England & Wales, which promotes accountability, transparency and reference to the actual investment practices of pursuers are all areas that could be improved in the Bill.

Other comments

12. Are there any other aspects of the Bill you wish to comment on?

The Bill is unclear on how it would operate if multiple discount rates were to be used. There is no provision for separate notional portfolios, as would be required for multiple rates. Neither does it allow for the hypothetical investor assumptions to be changed for multiple rates. Clarification is required on how the setting of multiple rates would operate.