ECONOMY, ENERGY AND FAIR WORK COMMITTEE

DAMAGES (INVESTMENT RETURNS AND PERIODICAL PAYMENTS) (SCOTLAND) BILL

DAC Beachcroft Scotland LLP

About Us

DAC Beachcroft Scotland LLP (DACB Scotland) is part of the DAC Beachcroft Group (DACB) which continues to be the “heavyweight” in Defendant Personal Injury law locally and nationally. DACB Scotland specialises in insurance litigation and dispute resolution, commercial dispute resolution, real estate and commercial law. The firm is acknowledged in Chambers and The Legal 500 as being at the forefront of insurance advice in Scotland. The insurance litigation and dispute resolution department is one of the largest in the country.

Across the UK the firm has a dedicated team of over 600 specialists based across 13 offices dealing with over 20,000 claims per annum across claims handling, pre litigation and litigation. Scotland is an integral part of that offering with 7 partners and over 40 solicitors and paralegals.

The firm acts for 19 out of the top 20 insurers in the UK and specifically acts for 9 out of 10 of the largest Commercial Motor Insurers (listed by GWP). The firm also acts for a number of corporate clients, including many household names listed on the FTSE 100.

The firm has an unparalleled reputation for catastrophic personal injury cases. The firm managed around 3,500 large injury & catastrophic loss claims in 2015, 20% of which were over £500k in value.

Our personal injury team has a deserved market-leading reputation for providing innovative and pragmatic solutions to liability claims disputes of all types and insurance issues generally. We pride ourselves on delivering commercial, value-driven legal services. With specialist expertise covering catastrophic injury, claims validation, costs, credit hire, disease and safety, health and environment law, the team covers the full range of personal injury work. Our strategic litigation unit offers a unique service for insurers dealing with emerging and important market issues.

As an associate member of the Association of British Insurers (ABI), we have had the opportunity to read its response to this call for views and fully endorse it.

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

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?

   1. DACB Scotland fully supports the principle of 100% compensation. The current law is not working properly to deliver that and is over-compensating pursuers. We welcome this long-overdue reform of the methodology for setting the discount rate and support the need for legislation in this area.
2. We have a number of concerns about aspects of the Bill, which we consider depart from the 100% compensation principle that must be inherent in the setting of the rate. These points would lead to significant over-compensation:
   a. the content of the notional portfolio, which appears over-cautious
   b. the additional adjustment which is described in the Bill as the “further margin”
   c. the assumption that the relevant period for investment is 30 years, which is too low
Each is discussed in more depth in our response to the next question.

3. The position in which catastrophically injured pursuers find themselves means that they should not be required to take the same level of risks with their investments that a normal investor may take; however, all of the evidence underpinning last year’s MoJ consultation demonstrated that adopting a “real world” investment strategy, as currently adopted by pursuers, does not equate to “very low risk” investments.

4. Additionally, those investors with a very low or no-risk investment appetite will have the option of a Periodical Payment Order (PPO) to reduce their risk. This should be taken into consideration when determining the level of risk pursuers are assumed to accept.

5. The Bill, as drafted, would over-compensate pursuers and the cost of that would be met by defenders including insurers, medical professionals, the NHS in Scotland and other public bodies. Scottish taxpayers will ultimately meet the costs of over-compensation by public bodies.

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?

6. DACB Scotland supports the overall aims of the Bill. It is agreed that the method and process are clear, certain, regular and transparent.

7. We have concerns about the fairness and the credibility of the outcome that will be delivered in part because of:
   a. The calculation of the notional portfolio
   b. The additional 0.5% adjustment – the “further margin” referred to in clause 10(2)(b)
   c. The assumption of a 30 year investment period

The notional portfolio

8. We are concerned that the notional investment portfolio as detailed in the Schedule to the Bill is over-cautious.
9. The GAD is to base the discount rate on the notional portfolio. That portfolio is:

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Scottish portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>7.5</td>
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<tr>
<td>Overseas equities</td>
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<tr>
<td>Nominal gilts</td>
<td>15</td>
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<tr>
<td>Index-linked gilts</td>
<td>10</td>
</tr>
<tr>
<td>High yield bonds</td>
<td>5</td>
</tr>
<tr>
<td>Cash</td>
<td>10</td>
</tr>
<tr>
<td>Property</td>
<td>5</td>
</tr>
<tr>
<td>Investment-grade bonds</td>
<td>30</td>
</tr>
<tr>
<td>Alternatives</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

10. In the English government's consultation for setting the discount rate, the GAD was instructed to analyse outcomes for claimants in receipt of lump sums under different illustrative discount rates. The portfolios the GAD was instructed to use were:

<table>
<thead>
<tr>
<th>Asset class</th>
<th>GAD portfolio A</th>
<th>GAD portfolio B</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>13</td>
<td>29</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>15</td>
<td>28</td>
</tr>
<tr>
<td>Fixed interest gilts</td>
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<td>7</td>
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<tr>
<td>Index-linked gilts</td>
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<tr>
<td>Corporate bonds</td>
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<tr>
<td>Cash</td>
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<td>5</td>
</tr>
<tr>
<td>Alternatives</td>
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<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

11. These portfolios were calculated by the MoJ after consultation with investment advisers and wealth managers. Portfolio A was deemed to be an average or typical portfolio invested in by personal injury claimants, based on evidence of what claimants do and are advised to do. Portfolio B was described as an average or typical but higher risk portfolio for personal injury claimants.

12. As an associate member, DACB commissioned, on the ABI's behalf, a report from Pannells Financial Planning Ltd, a firm of independent financial advisers, which is attached at Annex A of the ABI's response. In the report writers' expert opinions, the notional investment portfolio in the draft Bill is overweight in fixed interest investments and underweight in equities.

13. When the GAD's portfolios A and B are viewed alongside the notional portfolio, it is apparent that the GAD portfolios invest more in equities, with 28% and 57% respectively, compared to the notional portfolio's equities of 20%. The notional portfolio also has a much larger percentage of fixed income investments. This is especially unexpected given the investment horizon of 30 years. Pannells' report highlights that equity investments will provide protection against inflation over the longer term.
14. There has been no indication provided to date of how the notional portfolio was calculated. Unlike the GAD’s portfolios, we have not been informed that investment advisers or wealth managers were consulted. Additionally, there is no evidence that Scottish investors differ from other UK-based investors: quite the opposite. In its report, Pannells states: ‘we do not perceive any meaningful difference between investment strategies adopted by cautious/low risk investors in Scotland when compared to other parts of the UK.’

15. Because of these facts, we would expect the notional portfolio to resemble more closely the GAD’s portfolios A and B with a higher weighting towards equities. The notional portfolio itself is considered to be overly cautious.

16. We would also highlight that a pursuer who is particularly risk averse will have the option under this Bill of receiving damages in the form of a PPO. The availability of this lower risk option should be taken into consideration when calculating the portfolio to serve as the basis for setting the discount rate.

17. For these reasons, we believe the notional portfolio is over-cautious. We are concerned that over-compensation will become the norm, and that the costs of this will be passed on to customers and taxpayers.

The further margin

18. The Policy Memorandum published with the Bill states as follows:

   In changing the methodology away from a rate based on ILGS, the Scottish Government has made provision for a portfolio constructed on the basis of portfolios described as cautious and which the Scottish Government believes would meet the needs of an individual in the position of the hypothetical investor who is described in the legislation.

19. If, as the policy memorandum suggests, the cautious portfolio is appropriate to meet the needs of the hypothetical investor, then this additional 0.5% adjustment downwards inevitably goes beyond the needs of the pursuer and therefore beyond the 100% compensation principle. The “further margin” adjustment is unnecessary and fundamentally undermines this principle. Taken together, the over-cautious portfolio and the 0.5% further margin adjustment guarantee that the discount rate will deliver over-compensation to pursuers. This is acknowledged in the Financial Memorandum, which, at Paragraph 15 states: ‘there will inevitably be a probability of over compensation’. That comment does not factor in the over-cautious nature of the notional portfolio and refers only to the further margin.

20. There is no evidence in the Bill or supporting documents to support the policy decision to depart from the 100% compensation principle. Furthermore, a policy that inevitably increases the probability of over-compensation also increases the likelihood that insurance customers and taxpayers will face increased costs.
21. Any perceived under-compensation of pursuers in the past should not be taken into consideration when setting the discount rate for awards arising from current and future events. Over-compensating future pursuers does not correct any previous under-compensation of pursuers. There is in any event no objective evidence that pursuers receiving compensation since the Scottish Government first set the rate in 2002 have in fact been under-compensated.

30 year period

22. We are also concerned about the use of a 30 year investment horizon and the likelihood this has for over-compensation. ABI data demonstrates that the average investment period of 46 years is appropriate because it is the mean duration of future damages in those cases where the discount rate is a significant factor. DACB Scotland's view is that the 30-year period is too low and too cautious and is a further factor which will undermine the 100% principle.

Other comments

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

23. The negative discount rate in Scotland is, along with the equivalent rate in England and Wales, already an outlier compared with other jurisdictions. The assumptions set out in the Bill (over-cautious notional portfolio, 30-year period and additional 0.5% “further margin” adjustment) suggest that the approach to be taken in Scotland will produce a rate lower than that produced by the process in England & Wales. This outcome is likely to leave Scotland with the lowest single discount rate, suggesting an ongoing lack of balance in the setting of the rate in Scotland. The application of these factors is a political decision and not the responsibility of the rate setter, who would be following the requirements of the Bill.

24. This would not reflect a fair system that achieves the Scottish Government’s national outcome, nor does it meet the overall policy of Part 1 of the Bill, i.e. that it is clear, certain, fair, regular, transparent and credible. An outlier rate would not appear to be fair to consumers or taxpayers, and it would not appear to achieve a credible outcome.

25. A critical part of the use of PPO in England and Wales is the requirement that any settlement before or after court proceedings have been started requires the approval of the court to represent a valid discharge of the claim. This is more than a "rubber-stamp" exercise and will in practice involve written and oral submissions to the court as to the adequacy of the settlement. In high value cases where a PPO would be contemplated it would also involve the pursuer disclosing financial advice (to the court alone) as to the form of award which best meets their needs.

26. The Scottish Courts currently have no equivalent system requiring approval. We believe it forms an important safeguard for the interests of a child or other person lacking legal capacity to manage their own affairs. We would invite the Scottish Government to
consider either introducing similar provisions alongside this legislation or asking the Scottish Civil Justice Council to consider the issue.