

ECONOMY, ENERGY AND FAIR WORK COMMITTEE

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

SUBMISSION FROM THE ASSOCIATION OF BRITISH INSURERS

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. The ABI welcomes long-overdue reform of the methodology for setting the Discount Rate and supports the need for legislation in this area; we have long argued that a more stable and fairer method for setting the discount rate in the future is required and that the process should be more transparent for all parties.
2. However, we have a number of concerns about aspects of the Bill, which we consider departs from the 100% compensation principle that must be inherent in the setting of the rate. These points are developed further in answers below but would lead to significant over-compensation:
 - the content of the notional portfolio, which appears over-cautious;
 - the assumption that the relevant period for investment is 30 years, which is too short; and
 - the additional adjustment which is described in the Bill as the "further margin".
3. The insurance industry fully supports the principle of full compensation, i.e. 100% compensation: not more and not less. The current law is not working properly to deliver that and is over-compensating pursuers. As the Scottish Government recognises in its Policy Memorandum, no properly advised pursuer would ever invest all their damages in Index Linked Government Securities (ILGS). It is essential that the Discount Rate methodology accurately reflects how pursuers are advised to invest their awards, and delivers a clearer system that strikes a fair balance between the interests of claimants and the requirement for affordable access to insurance.
4. 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 consultation demonstrated that adopting a "real world" investment strategy, as currently adopted by pursuers, does not equate to "very low risk" investments. The ABI therefore welcomes the move away from the assumption that a pursuer is a "very low risk" investor.

5. The Bill, as drafted, risks over-compensating pursuers. The costs would be met by defenders including insurers, medical professionals, the NHS in Scotland and other public bodies. It could also be borne by small businesses where claims exceed their insurance limit of indemnity.
6. The introduction of Periodical Payment Orders (PPOs) is important, as they offer those pursuers particularly concerned about longevity, inflation and investment risk with the option of a very low risk form of compensation.
7. We are concerned that a review set every 3 years could drive undesirable outcomes and behaviours. Catastrophic injury claims take up to 5 years to settle, so there is a risk that claims stall as a result of speculation around the likely outcome of the next review. Whatever the result of such a review, this would not ultimately serve the interests of claimants.

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?
8. The ABI supports the overall aims of the Bill. It is agreed that the method and process are clear, certain, regular and transparent.
9. On September 6 the Scottish Government published additional information as to how the notional portfolio was constructed and we need to consider that information prior to determining how fair and credible the outcome delivered by the Bill would be. The ABI submitted a significant amount of evidence with its response to the 2017 consultation. The analysis underpinning that evidence is not reflected in the notional portfolio included on the face of the Bill. The ABI has obtained further evidence as part of this response from Pannells Financial Planning, a firm of independent financial advisers, which is attached as Annex A. Their report includes details of asset allocation indices from various investment houses, but again, these do not reflect the notional portfolio.
10. Pannells' view is that the portfolio is overweight in Fixed investments and underweight in Equity investments and with an investment horizon of 30 years they would expect to see more Equity investment included. The notional portfolio is over-cautious and a portfolio which has more weighting to Equity investment would be more appropriate if the 100% compensation principle is to be upheld. Pannells highlight that Equity investments provide protection against inflation over the longer term. As such, we

would encourage the Committee to ask the Scottish Government to demonstrate the evidence for its policy decisions in the Bill.

11. A further area of concern about the fairness and the credibility of the outcome that will be delivered is the additional 0.5% adjustment, the "further margin" referred to in clause 10(2)(b). 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."
12. 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 by definition goes beyond the needs of the pursuer and therefore beyond the 100% compensation principle. The notional portfolio is already over-cautious and the portfolio itself already risks departing from the principle of 100% or full compensation. The "further margin" adjustment is unnecessary and fundamentally undermines this principle. The over-cautious portfolio and the 0.5% further margin adjustment guarantee that the discount rate will deliver over-compensation to pursuers. We see no evidence in the Bill or supporting documents to support this policy decision. Furthermore, the provisions under Part 2 of this Bill will afford claimants the option of a very low risk form of compensation by way of a PPO.
13. These costs would be met by defenders: insurers, small businesses, medical professionals, the NHS in Scotland and by other public bodies. Ultimately the costs associated with that compensation approach would be met by Scottish consumers and taxpayers. We do not believe Part 1 of the Bill is fair or credible for defenders.
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?
14. There needs to be political accountability for the decision. We do not agree that the Bill as drafted removes the setting of the rate from the political sphere. The Bill sets out the rate-setter's remit very precisely: the decision to specify this portfolio and the additional adjustments is very much a political one. The only area of discretion that the rate-setter has is around the interpretation of "other types" of investment in the notional portfolio.

16. The Scottish Government retains the power to alter the notional portfolio by way of regulations as well as to alter the adjustments and tax considerations. Our assessment is that it will need to exercise this power before each review, to ensure that the assumptions made remain accurate. The remit, whilst precise, is therefore still open to significant political influence.
17. Pannells, in their report at Annex A, highlight that most wealth managers would review/revise the asset allocation of their portfolios on at least an annual basis. In our view, Scottish Ministers would need to consider investment practice and the make-up of a suitable portfolio and revise the notional portfolio before each review takes place, to ensure that they remain appropriate. The assumptions that are made by Scottish Ministers will therefore largely dictate the outcome. The ABI considers that external attempts to influence the decision, which has very limited potential outcomes due to the prescriptive nature of the Bill, will simply move to seek to influence these review points.
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?
18. The approach proposed in this Bill is significantly more rigid and inflexible than the approach to be taken in England & Wales. The Bill sets constraints on the rate-setter, the Government Actuary. It is clear from the Policy Memorandum that most responses supported the involvement of an expert panel to support the work to be completed by the Government Actuary, but the Bill does not require this.
19. The Government Actuary will, in practice, have access to, and be aware of, the views of the experts in this field. Pannells, in their report at Annex A, highlight that there are no factors that differentiate underlying investment strategies for Scotland; as such, the views of those experts will be equally applicable in Scotland as in the rest of the UK.
20. There are several points set out in the Bill which mean that the rate-setter's discretion as to the final rate is very limited:
 - 1) The impact of inflation. We note that inflation is to be allowed for by reference to the retail prices index (RPI). The ABI supports the use of RPI as the correct measure of inflation in this context, provided it is acknowledged that this is intended to incorporate suitable allowance for application to earnings-related losses (including the cost of care) and is not to be subject to further uplift for such types of loss.
 - 2) The 30-year investment period. The Government Actuary, in producing their report to accompany the UK Government's Civil Liability Bill, was asked by the Ministry of Justice to assume an average investment period of 30 years. However, it is not clear

where this assumption comes from. 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. The ABI's view is that the 30-year period is too short and too cautious and is a further factor which will undermine the 100% principle.

- 3) The standard adjustment of 0.5% as a further margin. There is no evidence to support a policy decision for this in the Policy Memorandum, or in fact in law. If the other factors in the setting of the rate are otherwise fair, this "further margin" inevitably goes beyond the needs of the claimant and therefore beyond the 100% compensation principle.

The scale of this adjustment must be seen in context. Without this adjustment, the Scottish Government anticipates that the discount rate indicated by the Bill's approach would be +0.5%. The Bill proposes that the rate should be set to the nearest 0.25% - see paragraphs 19 and 20 of Schedule B1. An adjustment of 0.5% therefore moves the rate two whole intervals down the scale.

In the context of a rate which is likely to be close to 0%, the proposed further margin of 0.5% is a large adjustment to the overall impact of the Bill; much larger than the same 0.5% adjustment would be if the rate were at its previous level of 2.5%. See the examples below:

A 30-year-old female is disabled in an accident and cannot work again. She has no educational qualifications and it is determined she would have earned £20,000 a year until retirement at 65. Rest of life care is determined to be £100,000 a year.

Rate without further margin deducted	Claim value	Rate with further margin deducted	Claim value
2.5%	£3,414,350	2.0%	£3,820,050
1.0%	£4,900,900	0.5%	£5,625,400
0.5%	£5,625,400	0.0%	£6,517,400

A 25-year-old male is severely disabled in a car crash and cannot work again. He has a degree and it is determined he would have earned £50,000 a year until retirement at 65. His cost of care is going to be £30,000 a year for the rest of his life.

Rate without further margin deducted	[Claim value*]	Rate with further margin deducted	[Claim value*]
2.5%	£2,083,125	2.0%	£2,300,070
1.0%	£2,858,310	0.5%	£3,221,325
0.5%	£3,221,325	0.0%	£3,659,325

21. Whilst we do not accept that any adjustment is required from the result produced by applying the other assumptions, there is an obvious and more equitable alternative if it

is considered essential to err on the side of caution. Currently under paragraph 20 of Schedule B1 the rate assessor is required to round their result up or down to the nearest 0.25%. That could be amended so that the rounding is only ever to the nearest 0.25% downwards. In that way, the rounding exercise would only ever work in favour of pursuers' interests but to a limited degree, consistent with the overall purpose of the setting of the discount rate and delivering an outcome that, as close as possible adheres to the 100% compensation principle.

22. The availability of a PPO removes the need for the additional 0.5% adjustment, in that any pursuer who is particularly concerned about longevity, inflation and investment risk can opt for a PPO.
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?
23. The ABI supports reviewing the rate at consistent intervals. Regular reviews mean that any changes to the rate should become incremental and would not result in a significant adjustment as occurred at the last review. The ABI also agrees that there should be flexibility to allow reviews to take place in the interim, should there be any good economic reason for such a review, albeit that we think this should be used sparingly.
24. A 3-year review cycle risks being too short, and we propose a 5-year cycle. Catastrophic injury claims can take up to 5 years to settle and so a longer interval would largely remove the risk of either party trying unnecessarily to speed up or slow down the settlement of an individual claim in the anticipation of a favourable change in the rate. We note that the Policy Memorandum indicates that more responses favoured 5 years than 3 years. In addition, a shorter 3-year term risks encouraging compensation setters to focus too heavily on short term factors at the expense of longer, more stable, factors underpinning the majority of future losses. In practice the rate of investment return required to achieve 100% compensation is to be derived by a combination of both short term and long term factors. An approach which requires a review every 3 years could distort settlements on a consistent basis over the longer term such that a claimant's compensation becomes based on when their claim happens to be settled rather than an objective assessment over the longer term.
25. It is also unclear why an interim review should have no effect on the 3-year review cycle. If an interim review does take place, the default position should be that the next review would be 3 years later, not at the end of the original 3-year period.

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?
26. The Scottish Government is right, both in changing the methodology to move away from a rate based on ILGS, and in assuming that injured people have access to the necessary expertise to allow for sufficient flexibility and to manage their risks. As the evidence provided to the 2017 consultation clearly demonstrates, no properly advised investor would invest solely in ILGS (or indeed in any single asset class). The Scottish Government is reflecting the reality of what pursuers are advised to do now.
27. In terms of access to advice, we note the submission from the Association of Personal Injury Lawyers (APIL) to the 2017 consultation who noted as follows:
- “APIL surveyed its members and asked them about the type of financial advice they offered to their seriously injured clients.
- “Sixty per cent of respondents indicated that their firm offers investment advice either in connection with lump sums, PPOs or both (56%). Only 11.85% of those offered the advice in-house: the majority (77.78%) referred their client to an external financial advisor while the remainder offered both options.
- “We questioned the 40 percent who indicated that their firm did not offer financial advice to these clients to find out what they did instead. The vast majority strongly recommend that the client seeks independent financial advice, and then either refer them on to an IFA or, if it is a Court of Protection case, they may offer the services of an in-house or externally referred Deputy. None of the respondents appeared to leave their clients without either financial advice or a referral on to an IFA or other appropriate professional provider.”
28. It is important to note that pursers will always have access to independent financial advice when their claim is being settled. However, given this advice is inevitably confidential to the pursers and their advisers, insurers do not have sight of the exact nature of the advice provided.
29. We repeat the points made above in response to questions 2 and 4, that the portfolio being proposed is already an over-cautious one and that there is no justification in that context for a further margin adjustment of 0.5% for additional caution. PPOs are the best option for pursuers with a very low or no risk appetite.

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?
30. The ABI supports Part 2 of the Bill in that it will put Scotland on the same footing as the rest of the UK. It is an important provision as it will mean that Courts can award a PPO where this is in the best interests of the pursuer.
31. Where a properly advised pursuer wants a PPO in an appropriate case, it is difficult to envisage a scenario where the court would decline to make such an order, as a PPO transfers the risk to the compensator for those pursuers who are most risk averse or where the court considers their interests need such protection.
32. The availability of a PPO further undermines the need for the additional 0.5% “further margin” adjustment to the discount rate which, as noted in our response to question 4 above, already means that awards will go beyond the 100% compensation principle. The 0.5% margin is said to be included to avoid the risk of under-compensation. Conversely, it will deliver a rate that results in over-compensation. It is not clear why the Scottish Government considers that to be necessary, when the approach to the investment portfolio is already over-cautious and those with the lowest risk appetite have the PPO option available to them.
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?
33. It is difficult to forecast how many pursuers will want a PPO. Many (if not most) are still likely to want the greater flexibility of a lump sum in the knowledge that this should meet their needs sufficiently. However, these provisions will enhance the choice that pursuers have as to the options for their future.
34. Pursuers should have the opportunity to choose to have (usually part of) their compensation paid to them in the form of a PPO. This reduces the risk that the compensation will not meet their needs sufficiently, because, for example, the payments will (in the case of lifetime needs) continue throughout their lifetime and will not be exhausted if they live significantly longer than expected (the mortality risk).

35. For pursuers with very low appetite for investment risk, PPOs also offer an acceptable alternative to investing their lump sum.
36. A critical part of the use of PPOs 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 to evidence the form of award which best meets their needs.
37. The ABI understands that 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, and 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.
38. It is not anticipated that the requirement for continuity of payment to be reasonably secure will have any significant effect on the number of PPOs. The vast majority of compensators will either be insurers covered by the provisions of the Financial Services Compensation Scheme or be public sector bodies.
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?
39. The proposals in the Bill would allow the courts to revisit a compensation award, but only in limited circumstances if: (a) there is a risk of a change in the pursuer's medical condition (as opposed to other circumstances); (b) such a change would result in significant over or under compensation; and (c) the risk is identified in the PPO. This approach is supported to otherwise maintain the principles of certainty and finality in awards of damages.
40. There needs to be express reference to a requirement for the change in the pursuer's medical condition to be attributable to the injuries arising out of the act or omission which gave rise to the claim in line with the approach adopted in the rest of the UK. This may not have been included because it was considered to be an obvious point. The ABI believes it should be stated expressly to avoid any uncertainty and any unnecessary satellite litigation.
41. The Bill adopts a slightly different approach than currently applies in the rest of the UK, by requiring the court to determine that any change which might occur would result in the pursuer being significantly over- or under-compensated. The interpretation of "significantly" may ultimately be the subject of satellite litigation, but this approach has the

advantage of excluding any changes which would have only a minor effect on the level of compensation that has been awarded. The ABI supports this approach. The provisions that apply in the rest of the UK simply require a serious deterioration or significant improvement which, in practise, might not have a significant effect on the level of compensation awarded. The approach in the Bill is more pragmatic, as it ties the change in the medical condition to the compensation.

42. The provisions that govern what can be done on variation in sections 2F and 2H provide the courts with a wider discretion than in the rest of the UK, because (in addition to enabling the courts to vary the amount and frequency of the periodical payments and/or award a lump sum) they enable them to vary the recalculation index and also the method by which the payments are made. These provisions would involve varying terms of the settlement which would not be influenced by a change in medical condition. The ABI considers that this goes too far and that these provisions should be removed.

43. In addition, the provisions also potentially convey a wider discretion than in the rest of the UK to award a (further) lump sum 'instead of, or in addition to, any future periodical payments in respect of future pecuniary loss'. The use of the words "or in addition to" might be thought to permit further damages to be awarded in addition to the variation of the PPO for other heads of loss which are not covered by periodical payments. This provision makes the potential for reopening the award too wide. There are other statutory provisions which permit the court to rule that a lump sum award can be reopened in defined circumstances. The words "or in addition to" should be deleted.

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?

44. This Bill relates to situations where people have been catastrophically injured through no fault of their own. The ABI supports putting pursuers on the same footing as those in the rest of the UK in terms of access to PPOs. Where pursuers are risk averse or where there is a real uncertainty about life expectancy then access to PPOs is important. PPOs also afford pursuers greater choice in how and when they receive their compensation.

45. A discount rate that underpins the 100% compensation principle is also vital. The current discount rate of minus 0.75% has created a system where pursuers are over-compensated for their losses. This cost of this is met by compensators, including insurers, medical professionals, the NHS in Scotland and other public bodies.

46. What is required to support the national outcome is a system that is fair to all. A system that ultimately delivers on the principle of 100% compensation is fair to all members of society. Ultimately the cost of compensation above 100% is one which is otherwise met

by insurance customers and tax payers in Scotland. The ABI strongly supports overall fairness and the concept of balance between members of society. The process for setting the discount rate must strike that balance and must not lead to over- or under-compensation.

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?

47. Subject to our concerns above, if this rate setting process is set alongside greater access to PPOs for those for whom a PPO would be most suitable, then the overall outcome is a system that is fairer for all. This should serve to balance the polarised interests.

48. Our understanding of the position over the last few years is that those supporting pursuer interests felt strongly that the previous discount rate of 2.5% was unfair as it was too high. However, the evidence clearly demonstrates that the current rate does not reflect actual practice, is unfair and too low. Both rates were set on a basis that is now seen as outdated and not fit for purpose.

49. Whilst both pursuers and defenders will have concerns about aspects of the draft legislation and, subject to our overriding points about the notional portfolio, the 30-year period and additional 0.5% adjustment above, it will broadly restore balance between the interests of pursuers and defenders. Subject to those points, the Bill ought therefore to be welcomed by all sides.

50. The need for regular reviews ought to be supported by all sides and such regular reviews, whether at 5 year intervals as the ABI prefers or at 3 year intervals as set out in the Bill, will go a long way towards smoothing out any periodical changes in the rate.

Other comments

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

51. The discount rate in Scotland is, along with the equivalent rate in England and Wales, already an outlier compared with other jurisdictions, given that it is a negative rate. 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.

52. 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 who have to meet insurance premiums and it would not appear to achieve a credible outcome.

53. The Bill provides that multiple rates could be set, should Scottish Ministers require this, by regulation. It is not at all clear how this could work. The Bill sets out a notional portfolio on its face and details the assumptions that the rate-setter is required to make in reviewing the rate. The Bill does not allow for a separate notional portfolio to be applied (which would be required if there were to be multiple rates) nor does it allow for the assumptions as to the hypothetical investor to be modified in a way that would allow for multiple rates to be set.

54. The Bill is quite clear that the current rate is to be a single rate. The ABI does not consider that the Bill, as currently drafted, is workable, were Scottish Ministers to decide that multiple rates should be set.