FINANCE AND CONSTITUTION COMMITTEE

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

SUBMISSION FROM

Response from the Association of British Insurers

Consultation

1. Did you take part in any consultation exercise pending the Bill and, if so, did you comment on the financial assumptions made?

Yes. The ABI has responded to all of the previous consultations on the discount rate and PPOs, and commented on the financial assumptions made. We support the principle of 100% compensation as the Discount Rate needs to deliver compensation for injured people but also a fair settlement for defenders including insurers, medical professionals, the NHS in Scotland and other public bodies. However, as the Financial Memorandum (FM) acknowledges “there will inevitably be a probability of over compensation” and that cost will be borne by the NHS in Scotland, other public bodies, and medical professionals as well as insurers. Scottish taxpayers will ultimately meet the costs of over-compensation by public bodies.

In every response it has been argued that it is necessary to move away from the link with Index Linked Government Securities (ILGS) and to apply a “real world” approach to investment which involves investment in a mixed portfolio holding a range of assets to reflect how pursers actually invest their damages.

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.

Pursers are low risk – not “no risk” – investors. As such, we supported a move away from using ILGS as a reference point for setting the Discount Rate and support the Scottish Government policy to do that.

The ABI provided evidence in its response to the consultation on the composition of low risk portfolios typically used by pursers to invest their damages. It is not clear, from the
evidence that the ABI provided, or from the work done by the Government Actuary’s Department (GAD) based on assumptions that it was asked to make by the Ministry of Justice for Discount Rate reform in England and Wales, how the assumptions leading to the notional portfolio were formulated. Whilst the notional portfolio reflects the type of portfolio in which a low risk / cautious investor could be advised to invest their damages, based on the evidence that from Pannells (see Annex A to the call for evidence response) and the work produced by the GAD, the portfolio is overweight in Fixed Interest investments and underweight in Equity investments. This will lead to the process providing an outcome that is too cautious, especially when the further margin of 0.5% is deducted (see below).

The ABI has argued that RPI is the appropriate index of inflation. Having obtained evidence on this point from Oxford Economics our view is: in a claim for personal injury which includes future losses the appropriate measure of inflation also needs to account for wages inflation and for owner occupier housing costs. Oxford Economics highlight that both are running at or very close to RPI and on that basis, and accepting that there is no truly accurate index, we consider that RPI is the more appropriate index of inflation for setting of the Discount Rate as it provides for greater fairness as between the parties.

The ABI did not comment on the assumption of a 30-year investment period for measuring returns. However, since the consultation ended we have provided evidence to the Ministry of Justice and HM Treasury which demonstrates that the average life expectancy (and therefore period of loss) for cases to which the discount rate would apply is in fact 46 years. This evidence was based on UK-wide data but would be equally applicable to Scotland.

As to the assumptions about the characteristics of the hypothetical investor, these are agreed by the ABI and reflect comments made in our previous responses.

The first of the standard adjustments is appropriate in reflecting the impact of taxation and investment advice and management. It is important to recognise that pursuers in receipt of financial advice will inevitably seek to maximise use of tax allowances and other tax efficiencies in setting up their portfolio, but that the charges for advice and management will be kept to a minimum, consistent with the level of investment involved.

The “further margin” adjustment is unnecessary and fundamentally undermines the principle of 100% compensation. The notional portfolio is already assumed to provide the return that a cautious investor with the characteristics of the hypothetical investor would require to meet their needs. As such, the 0.5% further margin adjustment guarantees that the discount rate will deliver compensation in excess of the 100% principle to pursuers.

As Paragraph 15 of the FM states: “there will inevitably be a probability of over compensation”. 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. Those investors with a very low or no-risk investment appetite will have the option of taking compensation under a PPO to reduce their risk, so the “further margin” adjustment is not justified. We see no evidence in the Bill or supporting documents to support this policy decision.
2. If applicable, do you believe your comments on the financial assumptions have been accurately reflected in the FM?

Not entirely. The ABI submitted a significant amount of evidence with its response to the 2017 consultation, none of which is reflected in the notional portfolio included on the face of the Bill. This will determine the cost of compensation for defenders. Furthermore, we do not support the “further margin” adjustment proposed in the Bill and the FM.

3. Did you have sufficient time to contribute to the consultation exercise?

Yes.

Costs

4. If the Bill has any financial implications for your organisation, do you believe that they have been accurately reflected in the FM? If not, please provide details.

No. Insurers will be directly affected by the Bill and we do not believe the financial implications have been accurately reflected in the FM. The industry supports the principle of 100% compensation and freedom of choice for investors. As long as the Bill delivers on the 100% compensation principle (see comments above about further margin adjustment) then the Bill will deliver a fairer outcome for pursuers and defenders. On freedom of choice in relation to PPOs, the Bill puts Scotland on the same footing as the rest of the UK – an outcome for which insurers have long argued.

The “further margin” adjustment would be an additional cost for insurers writing business in Scotland compared to other jurisdictions in the UK and would put inflationary pressure on premiums.

In paragraph 26 the FM sets out the impact that an assumed rate of 0% would have on the value of claims. Insurers question those calculations, as even on the over-cautious portfolio selected and using the adjustments which are challenged in part above, our member companies cannot reach the net rate of 0% cited in the FM. In any event, we disagree for the reasons above that this is the appropriate rate on the assumptions which should apply.
5. Do you consider that the estimated costs and savings set out in the FM are reasonable and accurate?

The estimated costs and savings set out in the FM appear accurate. However, as indicated above, the assumptions currently used would exceed the 100% principle of compensation and the costs of this would be borne by the NHS in Scotland and other public bodies, as well as medical professionals and insurers. The costs cannot therefore be considered reasonable.

We note paragraph 42 in the FM which warns that a Scottish Discount Rate set lower than the Discount Rate for England and Wales would mean a shortfall in public funding in Scotland, and that paragraph 43 forecasts that a Scottish Discount Rate of 0% and a 1% Discount Rate in England and Wales would mean a shortfall of £8m-20m for Scotland.

6. If applicable, are you content that your organisation can meet any financial costs that it might incur as a result of the Bill? If not, how do you think these costs should be met?

The additional costs incurred by the Bill would ultimately be met by Scottish taxpayers. Insurance costs would be likely to rise as a result of the Bill as currently drafted, adding pressure to insurance premiums. If it costs more to provide cover in Scotland as a result of this Bill then that is likely to be reflected in the price paid by customers. Organisations which self-insure, including the NHS in Scotland, local authorities and other public bodies would also see their liabilities and financial costs increase. This is why it is so important that the outcome is fair and adheres to the 100% compensation principle: any over-compensation delivered by the Bill would be paid by consumers and taxpayers.

7. Does the FM accurately reflect the margins of uncertainty associated with the Bill's estimated costs and with the timescales over which they would be expected to arise?

Yes. It should be noted that all cases settled after the new rate has been set will settle based on the new rate. The Bill could be seen to have retroactive effect, in that it will impact on claims brought before the date of the change. This is however, how changes to the discount rate have always been applied.

Wider Issues

8. Do you believe that the FM reasonably captures any costs associated with the Bill? If not, which other costs might be incurred and by whom?
There will be costs faced by the NHS and other public bodies which self-insure. There should be a decrease in the costs, but due to the over-cautious portfolio, the 30-year investment period assumed and the further margin adjustment, the decrease will not be as significant as it should be, leading to higher costs for the NHS and the public purse. Subject to this point, the comments on the NHS are agreed. For the public sector it is noted that there have been no settlements since the last rate change. It should be noted that there has been significant uncertainty since the rate change which has undoubtedly hampered the ability to settle claims swiftly and this may not reflect the true outcome once the position is more settled as a result of the Bill.

The FM does not address the substantial administrative costs that compensators face in delivering PPOs, nor the wider costs of PPOs for insurers in terms of increased capitalisation requirements, which are not faced by the NHS or the public sector. These are costs that would also add pressure to the premiums for the paying public and businesses in Scotland.

9. Do you believe that the FM reasonably captures any costs associated with the Bill? If not, which other costs might be incurred and by whom?

The FM indicates that the costs associated with the Bill relate mainly to the GAD and additional funding for the NHS. Taxpayers will ultimately need to fund these costs. Insurance premium payers in Scotland would ultimately meet the costs faced by insurers, albeit that it appears that the rate is likely to increase based on current predictions.