ECONOMY, ENERGY AND FAIR WORK COMMITTEE

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

SUBMISSION FROM: Professor Victoria Wass

25th October 2018

I am grateful for the invitation to assist the committee at its oral hearing ono 23rd October. I provide my written notes to the questions here in case these are helpful. I also provide answers to questions raised by members on 23rd which I did not respond to: the question on the benefits of a higher PIDR to the NHS (John Mason p.24) and the issue of PPOs returning to court after settlement and the costs associated with this (Colin Beattie p. 32).

The NHS as a defender will benefit from a higher PIDR. The benefit will be less than to insurers because the majority of large claims for future losses in the NHS will be settled on the basis of PPOs where the PIDR is not relevant. This is also a swings and roundabouts situation for the NHS because a shortfall in the lump sum for care will eventually fall back as a claim on the state. On balance I would expect the NHS to gain. In my view the cost of 100% compensation to the NHS is one of the legitimate arguments to move away from the 100% compensation principle, for example through the adoption of a new calculation methodology as proposed by the Bill. I am not necessarily opposed to a risk-based PIDR but it must be proposed in an honest way and with a honest consultation so that politicians, pursuers and the public understand that a risk-based PIDR ends the promise of 100% compensation. It is very expensive to remove all risk and when this expense is set against the cost of funding hospitals, doctors and nurses and medical equipment, a retreat from a risk-free PIDR might be the preferred solution. It will, however, always imply less than full compensation.

There was a question about going back to court on PPOs and the expense of going back to court. I am not aware that this is a common problem. My expertise is in indexation and I am aware of a need to return to court when there is an unanticipated problem with an index. This occurred once in 2011/12 in relation to the measure normally used to index care costs, ASHE 6115, in response to a methodological change. It was resolved co-operatively with the costs met by the NHS. I am also aware that the parties have settled on indexation measures which have subsequently proved to be unsuitable and have been forced to return to court. This has been in the absence of expert advice.

Written answers to agenda questions (grey shading indicates no response)

Discount rate

How do pursuers invest in their rewards? Research undertaken by the MoJ and others indicates that pursuers do not invest wholly or even mainly in ILGS but rather they invest in a mixed portfolio including risk-bearing assets. This cannot be relied upon as evidence that they are over-compensated. It likely reflects an attempt to make up shortfalls in their damages (see below for details of shortfalls) in which case it reflects under-compensation. More importantly, how the award is invested is irrelevant. Investment risk associated with a lump sum award is injury-related and pursuers are risk-averse. If they are required to bear risk in order to achieve the lump sum that delivers the court-determined cash flows, compensation must be less than 100%.

What is your view of how pursuers spend their money which relates to setting the rate for discounts?

Evidence that pursuers invest in risky assets does not and cannot imply that they are over-compensated. This is fundamental mistake made by MoJ and Lord Keen. The proposition that pursuers are over-compensated drives the Bill but the only evidence to support this proposition is that pursuers are observed to invest in risk-bearing assets. This falls well short of proof of support (see below). If pursuers are not overcompensated then the proposed changes mark the end to the principle of 100% compensation. The words “100%”, “neither more nor less” or “full compensation” appear 11 times in the policy memorandum which supports this Bill (SP Bill 35-PM) in the context of the 100% principle being delivered by the Bill. It appears in two sections of the SPICe Briefing document (SB 18-59) at pages 9 and 11. The committee needs to be sure that over-compensation is present when scrutinising this Bill because if not then the Bill cannot deliver 100%.

At an empirical level, the observation that pursuers invest in risky assets does not imply over-compensation. It is consistent with both under-compensation and overcompensation. Pursuers who experience a shortfall in their lump sum relative to their needs might wish to take a bet to earn a return that would make up some of that shortfall. The choice being a certain shortfall and a chance of break even or better (also a chance of a bigger shortfall). Sources of the shortfall are set out at 2a of my written submission and Q6 of PFP’s submission: (i) pursuers bear longevity risk (ii) pursuers must fund the wedge between the PIDR and the ILGS redemption yield (iii) pursuers must pay earnings growth in relation to their care package but they receive only prices growth in their award (iv) accommodation costs outweigh accommodation damages.

At a theoretical level over-compensation is impossible because pursuers are risk averse (risk imposes a cost on them) and because the investment risks proposed in the bill are all injury-related risks. Proof is available in Gunn and Wass 2018.

Over-compensation

Do you think that the requirements in the bill will result in over-compensation?

Requiring risk-averse pursuers to bear risk in order to meet a court-determined cash flow MUST result in under-compensation (in reality this increases undercompensation for reasons (i) to (iv) above)

Can you elaborate on how the reward of compensation is carried out and what effect does this have on the complainant if they get over-compensated?
The principle of 100% compensation requires a PIDR based on a risk-free assumption. Redemption yields on ILGS come as close as possible to delivering this principle – certain cash flow, protected from RPI inflation and secure. The reality of the PIDR is that it has always been above the ILGS redemption yield (see PFP written submission Q6 which tracks the wedge 2003-2018). Pursuers must invest in risky assets to make up the wedge. The Bill proposes to break the link between the 'risk free' rate and PIDR altogether. This will allow the wedge to increase further. The result will be that the pursuer must increase her exposure to stock market risk. I cannot find any source of over-compensation in the pre-bill PIDRs. I can only find under-compensation.

Removing setting the discount rate from the political sphere

Do you think the removal of setting the discount rate will be successful in eliminating external encouragement?

No it may well have the opposite effect. The pre-bill principle that the PIDR be set at the redemption yield on ILGS offers the greatest protection from external encouragement and political influence because the redemption yield is determined by the market. This point is made by the IFoA at its point 6 (p3).

A bit of background – the damages Act 1996 proposed that the PIDR be set by the courts with the Lord Chancellor/ Scottish Parliament as a backstop in case there were no/insufficient issue of ILGS. Before enactment political influence increased with the Lord Chancellor setting the PIDR but his/her methodology for doing so was bound by *Wells*. The Bill effectively removes the *Wells* constraint leaving the PIDR as an entirely political decision and therefore subject to influence from lobbying.

How the discount rate would be calculated

Investment risk, impact on pursuers – negative. Adds more investment risk to other risks and shortfalls. Pursuers are risk averse and these are all injury-related risks.

Does the procedure balance the interests of the pursuers and the defenders?
No it favours the interests of defenders. It transfers risk from the defender to the pursuer. Risk is costly for the risk-averse. Pursuers are disadvantaged by the Bill. Since they are not advantaged by the current PIDR (there is no over-compensation),

the Bill does not deliver balance. If it is accepted that pursuers are undercompensated, the Bill delivers greater imbalance. It is further from the 100% principle. If 100% compensation is regarded as being the fair outcome, it increases unfairness.

Inflation – is the Retail Prices Index appropriate? The RPI is no longer the preferred measure of UK price inflation. It is no longer (since 2013) a 'National Statistic'. It is also inappropriate as a measure of inflation for future losses and expenditures which are earnings-related. However, ILGS are indexed to RPI and this determines the inflation measure which ILGS protects against. Currently there are no gilts issued using a different index so the choice is limited to the RPI.

Potential for different discount rates in Scotland and England

Do you think there will be a difference created in setting the discount rate within Scotland and the rest of the UK? Yes

What would be the probable outcome of this theory? Different (higher) car insurance premia in Scotland would be predicted however the link between the discount rate and insurance premia has never been straight forward

Periodical payment orders

Why do pursuers prefer a lump sum payment? Most pursuers and their advisors would prefer PPOs for large, regular and predictably elements of the claim for example care costs. This is because PPOs remove risks (i), (ii) and (iii) above – longevity, investment and inflation risks. There are some downsides to PPOs including a reduction in flexibility. Financial Advisors would be well-placed to advise the committee on this question.

Is there any restrictions of using PPOs frequently? Yes general insurers are illplaced to finance long term liabilities and therefore they must pay heavily to take them on. (defender internal discount rate -1.5% - 2.0%). They strongly prefer a lump sum and are well-placed in the litigation process to drive through their preference in terms of facing lower litigation risk and deeper pockets.

Issues for the panel:

Are the provisions listed in the Bill strong enough in making sure that payments will be made? Yes against public body defenders. No against private insurers who will continue to drive the litigation outcome towards a lump sum.