FROM THE OFFICE OF THE JUSTICE MINISTER

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Christine Darrah
Clerk to the Committee for Justice
Room 242
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26 March 2021

Dear Christine,

DAMAGES (RETURN ON INVESTMENT) BILL

Thank you for your letter of 18 March 2021 in which you refer to a briefing paper provided to MLAs by the Association of British Insurers (ABI) in advance of the Second Stage debate on the above Bill.

The Committee has asked for the Department's views on 'the issues raised in the briefing paper regarding the notional investment portfolio used in the Scottish model to calculate a compensation settlement being overly cautious and the need to amend it to achieve a better balance of investments'.

The Department does not accept the ABI's view that the notional portfolio of investments provided for in the Bill is 'overly cautious'. The portfolio is intended to meet the specific needs of the hypothetical claimant as defined in the Bill – that is someone who is properly advised and investing their lump sum award of damages with the objective of covering the losses and expenses for which the award was made, so that the fund will be

exhausted at the end of the period of the award. The content of the portfolio is the same as that in the Scottish legislation, which was arrived at on the basis of professional advice and expertise. The Government Actuary's Department carried out detailed analysis of a number of funds that were categorised as 'low-risk' by a third-party investment research firm that is widely recognised across the industry, and the notional portfolio in the Scottish legislation was built with reference to those funds. The Department confirmed with GAD that the portfolio remains appropriate.

The Committee will note that the Bill requires the Department to review the content of the notional portfolio before every regular review of the rate (subsequent to the first review) to ensure that it remains suitable for investment in by the hypothetical claimant.

Yours sincerely,

[signed]

CLAIRE MCCORMICK DALO

NORTHERN IRELAND
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Claire McCormick
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18 March 2021

Dear Claire

Damages (Return on Investment) Bill

At its meeting on 11 March 2021, the Committee for Justice considered a briefing paper provided to MLAs by the Association of British Insurers (ABI) prior to the Second Stage debate on the Damages (Return on Investment) Bill.

The Committee agreed to request the views of the Department on the issues raised in the briefing paper regarding the notional investment portfolio used in the Scottish model to calculate a compensation settlement being overly cautious and the need to amend it to achieve a better balance of investments.

I attach a copy of the briefing paper and would appreciate a response by 9 April 2021.

Yours sincerely

Christine Darrah Clerk to the Committee for Justice

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Briefing on the Damages (Return on Investment) (Northern Ireland) Bill Second Stage Debate, March 9 2021

Executive summary

The Association of British Insurers (ABI) welcomes the introduction of this Bill to reform the methodology for calculating the Personal Injury Discount Rate in Northern Ireland. This reform is long overdue as the Discount Rate is currently set using an out-dated formula which does not reflect real-life circumstances. This means Northern Ireland is an outlier in both UK and international terms.

Plaintiffs and defendants need to see a more stable and fairer method for setting the Discount Rate. The Northern Ireland Discount Rate is still 2.5% despite major changes in the interest rates on Index Linked Government Securities (gilts), and reform to the process of calculating the Discount Rate in the UK's other legal jurisdictions since 2017.

However, the ABI does not support the Department of Justice's decision to use the methodology based on the Damages (Investment Returns and Periodical Payments) (Scotland) Act as this does not meet the principle of 100% compensation which is fair to all parties. The Bill as introduced would have a significant financial impact on compensators including insurers, organisations that self-insure, and public bodies including the Health and Social Care service in Northern Ireland.

What is the Discount Rate and how does it work?

The Discount Rate is a mechanism which aims to make sure a person receives 100% compensation when they have been seriously injured as a result of the negligence of another. In its 2020 consultation the Department of Justice set out that in a personal injury case the compensation settlement for a successful plaintiff will include damages for any future financial losses, such as their loss of earnings and cost of future care, which are usually paid by the defendant in a lump sum.

The Discount Rate is applied by a court to adjust that lump sum to take account of the return that may be earned from investing it, in accordance with the legal principle that claimants should be fully compensated for their losses but no more and no less. Compensation for these cases is mainly claimed against motor insurance (for road traffic accidents) or liability policies including Employers' Liability (for accidents at work) and Public Liability. The Discount Rate is also applied to NHS settlements for medical negligence, and by other public bodies liable in personal injury cases.

As the Justice Minister Naomi Long MLA said in the Department of Justice consultation paper:
"higher awards of damages are ultimately funded by businesses and consumers through higher insurance premiums, and by the taxpayer through higher payments made directly by, for example, the health service."

The ABI supports 100% compensation via a Discount Rate which reflects the real-life choices claimants make in their investments. The current system for calculating the Discount Rate in Northern Ireland – based on case law known as Wells-v-Wells - is fundamentally flawed as it is based on an out-of-date assumption that plaintiffs would invest their compensation in Index Linked Government Securities or gilts. To invest their compensation in gilts at current yield rates would mean plaintiffs losing part of their money which no one wants to see. This Bill is necessary in order to bring the Discount Rate methodology for Northern Ireland into the 21st Century.

Implications of lowering the Discount Rate

The lower the Discount Rate is set, the higher the compensation settlement that is paid to a claimant and the greater the cost to compensators, which include insurers (on behalf of their business or personal clients), the NHS and HSCNI, and other public bodies. Small changes to the Discount Rate can have major financial impacts. Insurance underwriters need to take this into account when setting premiums, which means the lower the Discount Rate, the more inflationary pressure there is on motor and liability insurance premiums. This affects the affordability of insurance for health professionals including GPs, for motorists, and for businesses.

Northern Ireland already has higher motor insurance costs than other parts of the UK, due to a combination of factors including higher accident rates, compensation payments and the legal costs involved in a compensation claim. The potential cost of a serious injury claim is incorporated into every motor insurance policy, and so a very low Discount Rate in Northern Ireland would put inflationary pressure on motor insurance premiums, in particular for young drivers who are at greater risk of being involved in an accident.

The health service in Northern Ireland is one of the biggest compensators for settlements involving the Discount Rate, usually in clinical or medical negligence cases. Changing the Discount Rate to figure lower than 2.5% or a negative number would increase the compensation costs for the HSCNI and the amount of funds it would need to reserve against future claims. GPs and other medical professionals could also see the cost of their indemnity insurance premiums rise.

A low Discount Rate would mean that as well as potentially facing increased premiums, businesses may need to increase the level of liability cover they typically buy from £2m up to as much as £10m of cover for claims against their policies. This would add a further cost burden to Northern Ireland's businesses when they are already facing the financial challenges of recovering from COVID-19 and the UK's exit from the European Union.

Our concerns with the Bill

The Bill proposes adopting the Scottish model for calculating the Discount Rate. This would outsource the process for setting the Discount Rate to the UK Government Actuary's Department and means the Justice Minister would have no accountability for the rate set in Northern Ireland.

The further margin adjustment of 0.5% in the Scottish model is designed to reduce the risk of undercompensation even though there is no evidence that under-compensation happens in the current system. It reflects a policy choice by the Department of Justice to increase the level of compensation for plaintiffs and go beyond the principle of 100% compensation . The further margin adjustment would add hundreds of thousands of pounds to the value of claims paid by public bodies and businesses.

The notional investment portfolio used in the Scottish model to calculate a compensation settlement takes an overly cautious approach to investments across different asset classes. This has the effect of depressing the Discount Rate which increases the cost of compensation. The portfolio needs to be amended to achieve a better balance of investments.

Adopting the Scottish model is likely to cost public bodies in Northern Ireland significantly more. The financial memorandum for the Scottish Bill noted that a difference of 1% between the Discount Rate in England and Wales and Scotland could result in an additional cost of up to £20m per annum for public bodies in Scotland. The Scottish Government is required to meet any deficit from its own reserves with no additional funding under the Barnett formula from HM Treasury.

Our recommendations

We believe MLAs should support the Bill at Second Stage as reform of the Discount Rate is long overdue. However, it is essential that the implications of a methodology which sets a very low Discount Rate are closely scrutinised and clearly understood by MLAs.

Passing the Bill as it is currently drafted would mean significant additional costs for compensators including insurers and public bodies which have not budgeted for such increased costs. MLAs need to be conscious of the potential financial implications for both the public and private sectors in the Bill.

The ABI agrees with the majority of respondents to the Department of Justice consultation last year that Northern Ireland should use the England and Wales model with a Discount Rate set with reference to assumed returns from a diversified portfolio of low-risk investments, and having regard to the actual investments made by plaintiffs.

This would give the Justice Minister responsibility for making the decision on the Discount Rate. The Minister should do this in consultation with an expert group including economists, financial advisers and representatives of claimants and compensators which could advise the Minister on the current and future economic environment; investment options and advice available to plaintiffs; and how plaintiffs actually invest their damages.

About the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across the country in building back a balanced and innovative economy, employing over 310,000 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London. Insurance supports 5,000 jobs in Northern Ireland and generates £539m per annum in Gross Value Added to the Northern Ireland economy.

The UK insurance industry manages investments of over £1.6 trillion, pays over £16 billion in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK.