Call for evidence: Damages (Return on Investment) Bill – a response from the Association of Personal Injury Lawyers (APIL) – April 2021

Introduction

The personal injury discount rate is vital to ensure that compensation does what it is required to do: return the injured person to the position in which he would have been if it were not for the injury. No more, no less. APIL has campaigned across the different legal jurisdictions of the UK to ensure the discount rate does just that, and we welcome the opportunity to respond to the call for evidence on the Damages (Return on Investment) Bill.

Since discussion about the Bill will, however, inevitably focus on the notional investment portfolio, we strongly recommend that evidence is sought from independent financial advisers (IFAs) who have experience with this type of investment. On that basis, we will restrict our comments primarily to points of principle.

100 per cent compensation

To achieve as close to 100 per cent compensation as possible, the most appropriate methodology to calculate the discount rate is the current method, as set out in *Wells v Wells [1999] 1 AC 345*. Any move away from that methodology risks leaving injured people undercompensated.

Under the current method, injured people are assumed to be very risk averse or "risk free" investors. This is the best hope they have of obtaining full compensation for their catastrophic injuries.

Injured people are right to be risk averse. They are not stockbrokers. The compensation they are given is all they will ever have, and many live in fear of what will happen if the money runs out. Many survive – rather than actually live – in fear of what will happen if the money runs out. Damages must, therefore, be calculated on the assumption of risk-free investments, as recognised under the current method, and the rate should be reviewed on a regular basis. This is an issue of need: the actual concrete needs of people who have been injured through negligence must be met in a fair and just way.

Paragraph seven on page two of the Bill's explanatory and financial memorandum refers to evidence which found that "while claimants should be treated as more risk averse than ordinary prudent investors, in reality they would be advised to invest in a low-risk diversified portfolio rather than very low-risk ILGs (index-linked gilts) alone"[12]. Any analysis of claimant investment behaviour carried out under the current 2.5 per cent discount rate is, however, highly misleading.

Under the artificially high 2.5 per cent discount rate, claimants have been often forced into the invidious position of having either to take chances with their compensation by putting it in higher risk investments or struggling to make ends meet.

In an article for the Journal of Personal Injury Law, financial adviser Edward Tomlinson revealed the scale of the challenges faced by injured people under the 2.5 per cent discount rate[3]. Mr Tomlinson states that, under the 2.5 per cent discount rate, taking into account inflation, charges and tax, an injured person would have had to have made a profit on the investment of between 6.9 per cent and 12.5 per cent a year just to ensure the compensation payment reflected what was originally awarded by the court. It is impossible to envisage how anyone could have made that level of profit on investment during the straitened economic circumstances of recent years.

Risk of under-compensation

In moving away from *Wells v Wells*, the Department of Justice has decided to adopt the model used in Scotland, as opposed to the model used in England and Wales. While neither system is perfect, as they move away from treating injured people as "risk free" investors, there are aspects of the Scottish system which make it preferable to the system which has been implemented in England and Wales.

The standard adjustments included in the schedule on page six of the Bill, for example, will add transparency to the setting of the discount rate. We are concerned, however, that the standard adjustment of 0.75 per cent for the impact of taxation and the cost of investment advice and management is too low and could lead to under-compensation.

We have consulted with Richard Cropper, an independent financial adviser at Personal Financial Planning Ltd, who told us:

---

[1] http://www.niassembly.gov.uk/globalassets/documents/legislation/bills/executive-bills/session-2017-
[2] /damages-bill/efm---damages-return-on-investment-bill---as-introduced.pdf
[3] The Discount Rate, What's Next? By Edward Tomlinson, 2017 JPIL Issue 2, page 108

"With regard to investment costs, financial advice…is made up of financial planning advice and investment management. Suitable independent advice and investment management will incur a charge of between 1.5 per cent and 2 per cent per annum. As a result, the impact of advice costs has been materially under-estimated".

In an independent briefing for APIL written at the time legislation was going through the Scottish Parliament, but which still applies to this Bill, Mr Cropper went on to say that the impact of taxation is impossible to estimate accurately in advance as it depends on many factors, all which change over time, and some of which change day by day. On that basis, he says the allowance for investment advice and tax "is almost certainly bound to be too little".

During the passage of the legislation in Scotland, we supported an amendment which would have increased the allowance to 1.5 per cent. In introducing her amendment at stage 2 of the Bill's legislative proceedings, Jackie Baillie MSP shared the views of other IFAs:

"Paul Rosson, an independent financial adviser, said that the smaller the award, the closer to 2 per cent the costs are likely to be. That is simply for independent advice, and does not include any tax. He recognises that, although in the case of a moderate award the cost would be 0.5 per cent across the industry, that does not include any tax. Finally, Graeme Lind, from Tilney Financial Planning, which is based in Edinburgh, said that the standard rate would be 1 per cent plus VAT but that taxation would take the figure "north of 1.5 per cent per annum"[1].

We supported the amendment, which was necessary to ensure injured people were not under-compensated. Members of the Northern Ireland Assembly now have an opportunity to go further than the Scottish Parliament, and ensure the adjustment is at an appropriate level. We therefore propose the following amendment to the Damages (Return on Investment) Bill:

Schedule, page 6, line 18

Leave out '0.75' and insert '1.5'.

The role of the Government Actuary

There is no legitimate reason or necessity for political involvement in setting the discount rate. It is an actuarial task, and not a political one. We support the decision of the

[1] Damages (Investment Returns and Periodical Payments) (Scotland) Bill stage 2, 22 January 2019, https://archive2021.parliament.scot/parliamentarybusiness/report.aspx?r=11904

Department of Justice to transfer responsibility for setting the rate to the Government Actuary.

It is important to recognise, however, that the Department of Justice will still retain overall responsibility for the methodology to set the rate. If at any point it becomes apparent that the methodology is no longer appropriate, the Department of Justice will be able to change either the notional portfolio, or the entire methodology.

About APIL

The Association of Personal Injury Lawyers (APIL) is a not-for-profit campaign group which has been committed to injured people for more than 30 years. Our vision is of a society without needless injury but, when people are injured, they receive the justice they need to rebuild their lives. We have more than 3,200 members who are committed to supporting the association's aims, and all are signed up to APIL's code of conduct and consumer charter. Membership comprises mostly solicitors, along with barristers, legal executives, paralegals and some academics.

For further information please contact:

Sam Ellis
Public Affairs Officer, APIL