Damages (Return on Investment) Bill - call for evidence issued by the Committee for Justice

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Damages (Return on Investment) Bill - call for evidence issued by the Committee for Justice - response by BLM

About BLM

BLM is a leading insurance law firm which practises across all UK and Irish jurisdictions. We act for insurers and a wide range of other compensators and defendants. In addition to our two offices in Northern Ireland, we operate from eleven other bases across the UK and Ireland https://www.blmlaw.com/about-us

We are pleased to have been able to take part in this call for evidence and shall look forward to hearing further from the Committee as it undertakes its scrutiny of this important legislation before the short recess at the end of October 2021. Please do not hesitate to contact us should there be anything in our response on which further commentary is requested or should it be thought helpful to hear from us during any oral evidence phases of this Committee Stage process.

Introductory points

We submitted a detailed response to the Department of Justice's (DoJ) consultation conducted in summer 2020 which asked about broad possible options for a new legal framework for the personal injury discount rate (PIDR) in Northern Ireland. The essence of our response[1] was that we

(i) agreed with the DoJ's conclusion that investment decisions by claimants in Northern Ireland are likely to be similar to those made by claimants in other jurisdictions (by implication, elsewhere within the United Kingdom)

(ii) agreed that the legal framework for setting the PIDR should no longer be tied to *Wells v Wells*, because the principles in that case and in the Damages Act 1996 were no longer fit for purpose

(iii) favoured the English & Welsh model in which setting the PIDR is a matter for Ministerial discretion as opposed to the Scottish model, which requires the Government Actuary to perform a series of technical adjustments to the investment return on a prescribed notional investment portfolio, and

(iv) accepted the need for future reviews of the PIDR at regular intervals.

Following the 2020 consultation, the Minister for Justice and the DoJ set out their preferred way forward, which was to proceed directly and as quickly as possible to legislate for a new PIDR and not, in the meantime, to introduce an 'interim' PIDR based on *Wells*. This approach was the subject of judicial review (JR) proceedings earlier this year. In addition, the DoJ's intention to legislate quickly - whether by seeking formal "accelerated passage" for the Bill or by adopting a condensed Committee Stage which would have ended in April 2021 - was resisted by the Committee.

[1] Which can be made available to the Committee on request.

The outcome of the JR proceedings was that the DoJ withdrew its defence and at the same time reversed its decision not to introduce an 'interim' PIDR. That 'interim' *Wells*-based rate will be -1.75% and it will take effect from 31 May 2021.

This is therefore the context within which the current Bill is proceeding. The choice of the Scottish model rather than the English model has been made by the DoJ and the Minister. Although it was not our preferred model (see (iii) above), we accept that there are respectable policy reasons for selecting it for the new legal framework in the present Bill. The reasons for selecting that model have been articulated at length in the DoJ's post-consultation document[2], in subsequent correspondence from the Minister, during her appearances before the Committee and in her interventions at the Second Stage debate. Therefore we will neither extensively revisit them in this response nor seek to re-open the debate on the choice of model.

Our responses to the questions in the call for evidence

The Committee will be considering the following issues when scrutinising the Bill and would welcome views on them:

- ***Is the new statutory methodology to calculate the personal injury discount rate the most appropriate to achieve as close to 100% compensation as possible?***

  Examining the 100% principle

  It is first necessary to explore what the 100% compensation principle may mean. In any given case, it may be taken to mean that a claimant/plaintiff will receive the precise amount of compensation he or she requires to meet his or her needs caused by the accident, no more or no less. This characterisation of the principle is widely understood and agreed. It is relatively straightforward to apply in vehicle damage cases and in minor injury claims because there will generally be concrete forensic evidence of past losses and case law guidance on injury damages[3].

  However, cases in which the PIDR is used to calculate lump sum awards are by definition the most serious injury claims types, involving the future needs of the claimant/plaintiff, often over a long period, in respect of ongoing medical care and/or loss of earnings. The levels of these elements are not at all certain. In order to arrive at financial figures to resolve cases, hypothetical assumptions inevitably have to be made about clinical progress and care needs as well as about probable future career development (in respect of future loss of earnings claims). We must emphasise that this analysis should not be taken as in any way belittling the efforts made in these cases: we recognise that expert clinicians, forensic

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[2] https://www.justice-ni.gov.uk/sites/default/files/consultations/justice/summary-response-personal-injury-discount-rate.pdf

[3] Such guidance is consolidated in the *JSB NI Guidelines for the Assessment of General Damages*: https://www.judiciaryni.uk/sites/judiciary/files/mediafiles/Green%20Book%202019%20Fifth%20Edition%2025.02.19%20PDF.pdf

accountants, legal representatives and the judiciary all do their very best to value claims as fairly and accurately as possible on the materials available.

Although necessary to the process of reaching a claim value, the assumptions made will be inherently flawed. Projections of life expectancy will turn out to be either pessimistic or optimistic. Future clinical needs are unlikely develop as precisely as set out in expert evidence on the topic. Projected career paths are purely hypothetical as it can never be proven what would have taken place had the accident not happened.

In summary, assessing future losses in personal injury cases using a discount rate based approach will always have inherent flaws because assumptions about the future necessarily have to be made, and fixed, once and for all at a given point in time (the day of settlement or trial). As has already been said in the current context:

> *The overall objective … is 100% compensation. It is not an exact science … Everybody is trying to achieve 100% compensation.*[3]
>
> *However, none of this is an exact science.*[4]
>
> *The rate has to be set on the basis of 100% compensation. I agree with Mr Allister that achieving 100% compensation is never an exact science.*[4]
>
> *In moving away from a rate based on ILGs to a new methodology for calculating the rate of return, the intention is to give effect to the core legal principle of 100% compensation, whilst recognising this is not an exact science and therefore any excesses of potential over-compensation need to be properly balanced.*[5]

It is also possible to look at 100% compensation at a macro level. Here, the statistical concept is that over a large number of cases any levels of over or under compensation due to the approach adopted would broadly even out over the group of cases as a whole.

Under this idea, the 100% principle would be respected by setting a PIDR at the median point in the population of claims, meaning that half of the claims were overcompensated and half were undercompensated. Although finding that median (or 50/50 point) would simply be a question of

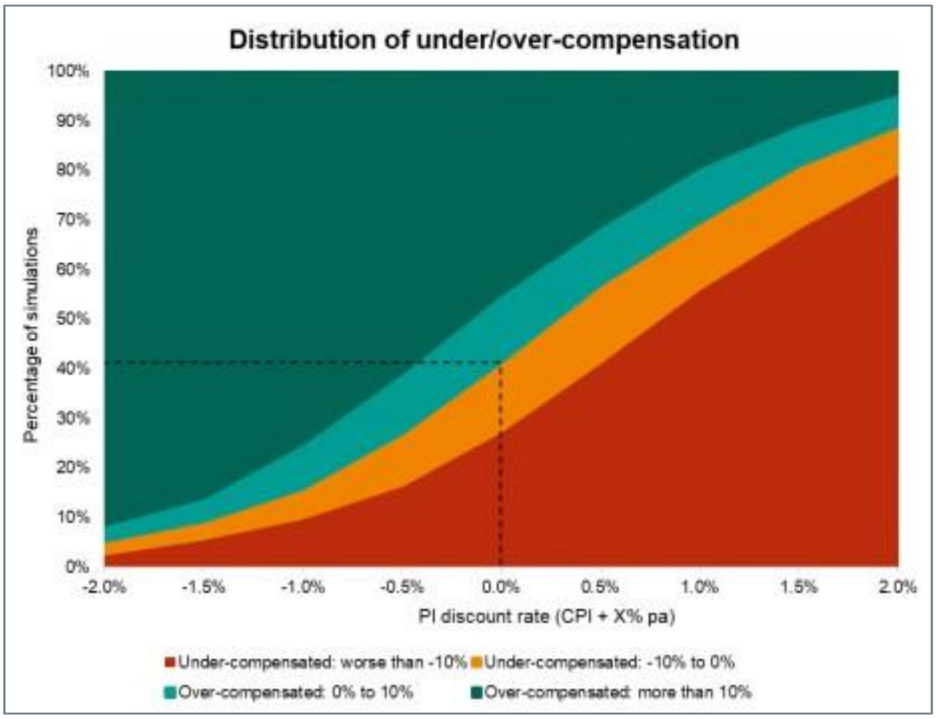
[3] Laurene McAlpine, Deputy Director, DoJ Civil Justice Policy Division, appearing before the Committee on 3 December 2020.

[4] Justice Minister Naomi Long MLA during the Second Stage debate on 9 March 2021.

[5] At 15 of the Explanatory and Financial Memorandum accompanying the Bill: http://www.niassembly.gov.uk/assemblybusiness/legislation/2017-2022-mandate/primary-legislation---bills-2017---2022-mandate/damages-bill/efm---asintroduced/

statistical analysis, as a policy choice it might be thought unattractive because it is implicit in it that half of the claims will be under compensated.

The boundary between over and under compensation at this macro level was set out by the Government Actuary in his 2019 advice[6] to the Lord Chancellor in England & Wales. The chart from page 18 of that advice is copied below.



Over compensation is shown in the dark and light green areas. Under compensation is shown in the red and amber areas. The vertical axis represents the proportion of cases and the horizontal axis plots the PIDR. The split between over and under compensation at any given PIDR is represented by the boundary between the amber and light green areas.

The chart shows that median compensation arose (at that time and using the investment risk basis and portfolio of the English approach) at a PIDR of +0.25%. The Government Actuary commented on this at 2.2 of his advice:

> *"Whilst it is possible to set the PI discount rate equal to this net median level of return, there is a 50/50 likelihood that a claimant experiences a rate of return that is lower than this. To safeguard claimants from the likelihood of not being able to meet their needs, it may be considered appropriate to set the PI discount rate at a lower level."*

[6] The advice may be found at the following URL: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/817236/Setting_the_Personal_Injury_Discount_Rate__web_.pdf

The question about the most appropriate method of achieving 100% compensation?

The approach in the Bill reflects the DoJ's policy choices following a detailed consultation with stakeholders across NI. It is grounded in evidence in so far as those views have been taken into account and the approaches in England & Wales and Scotland have been analysed in order to obtain evidence from those experiences to inform the drafting of the Damages (Return on Investment) Bill.

Achieving 100% compensation may be an established principle and goal but implementing it in practice is not, in our view, susceptible to a single answer. A range of approaches is possible depending on important and detailed policy choices about assumed investment risk, composition of the notional portfolio and about broadly acceptable overall levels of over or under compensation within the system.

The new approach in the current Bill is one of a range of possible approaches to achieving outcomes that are as close to achieving 100% compensation as possible. It is an appropriate means of achieving 100% compensation in so far as that principle is framed in practice by the policy choices DoJ has made in formulating the Bill.

Different policy choices might reasonably have been made in developing a statutory methodology (as has been the case in England & Wales and in Scotland) and if so those would also have been appropriate in achieving, within the frameworks described by those policy choices, outcomes as close to 100% as possible.

We therefore find it difficult to assert that one particular approach is, objectively, **the most** appropriate. Enacting the 100% principle in a legal framework requires a number of subjective (and difficult) choices about investment and risk. Inevitably, therefore, there is room for argument on such matters. Nevertheless, our view is that the DoJ has explained its choices on such issues and has for the most part been able to provide evidence in support of them.

- ***Has the new methodology the potential to veer towards over compensation and if so how can this be rectified?***
- ***Has the new methodology the potential to veer towards under compensation and if so how can this be rectified?***

Any PIDR methodology will tend towards over compensation if the rate it generates is materially lower than the investment returns that are reasonably achievable in practice by those in receipt of awards calculated using that PIDR.

Conversely, any PIDR methodology will tend towards under compensation if the rate it generates is materially higher than the investment returns that are reasonably achievable in practice by those in receipt of awards calculated using that PIDR.

The fundamental elements of a PIDR are as follows:

(i) the assumed investment risk profile of the hypothetical investor

(ii) the selection of a portfolio of investments to reflect that risk profile (iii) the period over which those investments are assumed to be held

- an average annual investment return is then produced, which may be adjusted

(iv) to take account of inflation, tax and investment charges, and

(v) to provide a margin against risks of over or under compensation.

These elements are dealt with in the present Bill as follows and we comment on each in the table below.

PIDR element		Provision in the Bill - schedule	- summary	Comment
(i)	**hypothetical investor**	17	a recipient of damages who invests as advised	
(ii)	**investment portfolio**	12	set out in detail at 12(3)	• The selected portfolio is identical to that used in Scotland • It is however more conservative than the portfolio in England & Wales and therefore delivers a lower rate of return
(iii)	**investment period**	7(2)(b)	43 years	• This is the same as in England & Wales and is based on analysis by the GAD
(iv)	**inflation**	9(2)	the default is the Retail Prices Index (RPI)	• The RPI is used in Scotland but the Consumer Prices Index (CPI) is used in England & Wales • The RPI is now generally regarded as unsuitable for official purposes[8]
	tax & charges	10(2)(a)	0.75%	• This level of adjustment is prescribed in the Scottish legislation • It was also selected as a matter of discretion by the Lord Chancellor[9] in England & Wales following advice from the GAD.
(v)	**risk margin**	10(2)(b)	0.5%	• This level of adjustment is prescribed in the Scottish legislation • It was also selected as a matter of discretion by the Lord Chancellor in England & in order to move away from median compensation (as has been described above) and to protect against the risk of under compensation[10]

[8] For further information see the general ONS commentary on the shortcomings of RPI https://www.ons.gov.uk/economy/inflationandpriceindices/articles/shortcomingsoftheretailpricesindexasameasureofinflation/2018-03-08
& commentary on RPI at heading 7 of ONS's March 2021 bulletin https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/march2021

[9] At 13 of his 2019 reasons: http://data.parliament.uk/DepositedPapers/Files/DEP20190748/PIDR_Statement_of_Reasons.pdf

[10] At 17-22 of the 2019 reasons.

In broad terms, therefore, the statutory methodology set out in the NI Bill would be likely - if the various rate-setting procedures were conducted at the same in all three jurisdictions- to deliver a PIDR for NI which would[7] be

 lower than that in England & Wales, because the investment portfolio is more conservative, but higher than that in Scotland, because of the longer investment period.

We do not regard such an outcome as necessarily "veering" towards either over or under compensation.

Is there double counting of risk in the new legal framework?

One final technical point needs to be made with regard to these five elements of the PIDR and in particular the direct copying from the Scottish model. We suggest there is a 'double counting' of risk in the proposed methodology which would render the resultant PIDR lower than it should otherwise be, an outcome which would tend towards over compensation.

What we mean is that using a notional portfolio that is more conservative (from an investment risk perspective) and thus *different* from that in England but then subsequently making the *same* adjustment as in England (ie 0.5%, the *"further margin"* at 10(2)(b) of the schedule of the Bill) for the risk of under compensation (see paragraph 20 of the Lord Chancellor's reasons) appears to us to be allowing for the same risk twice.

It seems logical that this risk should be allowed for only once. Given that the Bill already makes such an allowance in the construction of the notional investment portfolio, it would appear to follow that the proposed subsequent reduction via the further margin of 0.5% would amount to double counting, ie adjusting twice for the same factor[8]. It may be that reducing the further margin, say to 0.25%, could be a reasonable way to proceed as a rough rule of thumb and in the absence of specific evidence on the point.

A matter outside the scope of the Bill: the -1.75% 'interim' PIDR

Away from the Bill, but in so far as 'veering' represents a violent and significant change in direction, we are very firmly of the view that the new statutory rule[9] which will take effect on 3 May 2021 and set a

[7] Subject to the rounding to the nearest 0.25% as set out at paragraphs 19 & 20 of the schedule.

[8] It should be noted that this double counting anomaly is present in the Scottish legislation on which the current Bill is based.

[9] Which is to be brought forward by the DoJ under powers in the Damages Act 1996 (unamended).

Wells-based PIDR of -1.75% may be fairly described as 'veering' inevitably towards guaranteed overcompensation.

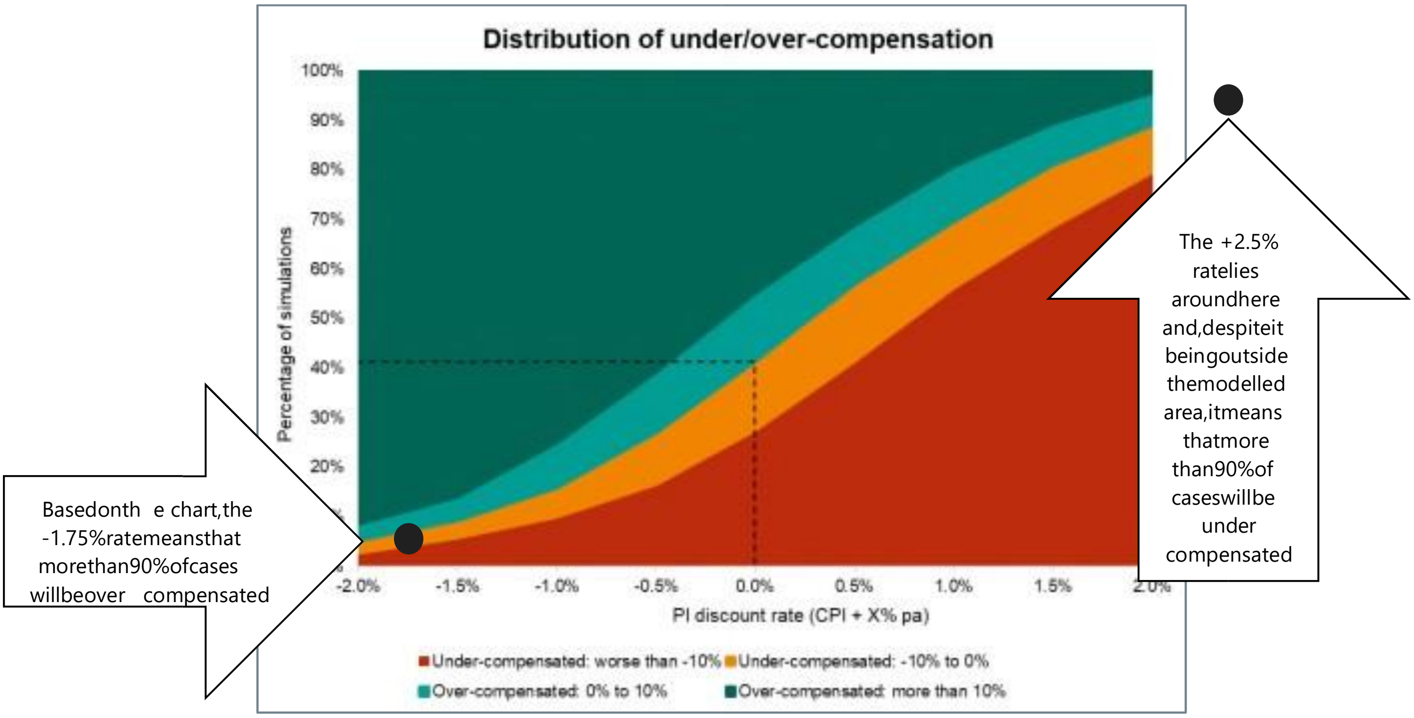
The adverse effects of over compensation have been clearly set out by DoJ:

> *"If claimants receive higher returns than are assumed under the discount rate, they will be overcompensated. Over-compensation means that compensators, including insurance companies and the public sector (most significantly, the health service) pay more than is necessary to compensate people for personal injuries. This may increase the cost of insurance to businesses and consumers, and is likely to reduce the amount of funds available for direct spending on health and other public services."*[10]

The imminent rate of -1.75% represents a dramatic move from the outmoded rate of +2.5% and we say this new rate swings the pendulum away from under compensation to extreme over compensation. We say that each of these rates is unsustainable because they are extremes.

We reproduce below the GAD already chart shown above. We have added black circles to represent where the rates of -1.75% and +2.5% should appear on it. Our comments in the arrow figures at each side indicate our view that both rates represent polarised extremes of under or over compensation. It is therefore vitally important, in the interests of all stakeholders, that the current Bill proceeds as quickly as possible to set a sustainable PIDR at a much more realistic and balanced level.

[10] At 3.2 of the summary of consultation responses. https://www.justiceni.gov.uk/sites/default/files/consultations/justice/summary-response-personal-injury-discount-rate.pdf



- ***Does the new statutory methodology reflect how a claimant would be advised to invest their award?***

  The new methodology may be said to reflect how claimants might be advised to invest and it reproduces the approach in Scotland. We have already said that we believe it is somewhat more conservative when compared to the approach in England & Wales.

- ***What are the likely effects of using an investment period of 43 years rather than 30 years in the model and do you agree with this approach?***

  As noted above, the longer period is likely to produce higher rates of return and, all other things being equal, a slightly higher discount rate[11]. The 43 year period is based on the GAD's analysis of evidence and its modelling carried out in England & Wales in 2019.

- ***What are the advantages or disadvantages of transferring responsibility for setting the rate from the Department of Justice to the Government Actuary and is there an appropriate level of accountability in the new statutory methodology?***

  We said the following in our response to the DoJ in 2020:

[11] Unless the difference lies within the rounding to the nearest 0.25% as set out at paragraphs 19 & 20 of the schedule.

In our view, the setting of a PIDR should properly be regarded as a political issue. It is something in which the interests of a wide range of stakeholders need to be taken into account because of: the economic importance of the decision for claimants and public or private sector compensators, the long-term nature of the award derived using the PIDR and, importantly, the need to achieve as far as possible 100% compensation and in so doing avoid putting in place a system which is inherently biased to over or under compensation across the board.

This is not the system proposed in the Bill, which follows Scotland and puts those issues and that political balance on the face of the Bill and therefore in the hands of legislators rather than a Minister. That is an entirely respectable alternative approach which, in effect, 'front-loads' the detail of rate setting into the Bill rather than leaving it as subject to Ministerial discretion.

The key concerns with this alternative approach are that (a) the details are addressed in a balanced and appropriate way in the wording of the Bill and (b) it provides sufficient flexibility (as there would be in the case of Ministerial discretion) to change particular elements if circumstances necessitate doing so. Subject to all the observations we have made in this response, we believe that our point (a) is generally met and w that the regulation-making powers set out in the schedule (at 7, 11, 13, 14, 15 & 16) should be largely adequate in respect of our point (b).