IUA Response: Northern Ireland Committee for Justice Call for Evidence on the Damages (Return on Investment) Bill

1. Thank you for inviting feedback as part of this Call for Evidence on the Damages (Return on Investment) Bill.

International Underwriting Association of London (IUA)

2. The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. It exists to promote and enhance the business environment for its members. The IUA's London Company Market Statistics Report shows that overall premium income for the company market in 2019 was £27.633bn. Gross premium written in London totalled £21.436bn while a further £6.197bn was identified as written in other locations but overseen by London operations.

Question 1 - Is the new statutory methodology to calculate the personal injury discount rate the most appropriate to achieve as close to 100% compensation as possible?

3. The IUA is broadly supportive of the proposed Damages (Return on Investment) Bill. It is our view that the Bill should be progressed as a matter of urgency in order to bring a stable, longer-term rate within this new framework, replacing the proposed -1.75% interim rate. We consider this the most fundamental point that should arise from this Call for Evidence.

4. The proposed -1.75% interim rate is based on outdated methodology and will severely impact upon the well-established 100% compensation principle. As such, we fully support the intention to break the link to the Wells v Wells case and, as outlined in the Explanatory and Financial Memorandum, to acknowledge 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 alone. We also firmly support the overall intention to ensure the rate is set in a way that gives effect to the 100% rule and is fair to both claimants and defendants.

5. In respect of the -1.75% interim rate and to highlight the fundamental need for new methodology and a new rate in Northern Ireland, it should be noted that a rate of -1.75% would bring forward the lowest discount rate in the world, which would inevitably lead to the expectation of significant over compensation. The implementation of similar rate changes in previous examples have resulted in increases in motor and liability insurance policy premiums, including when the discount rate in England and Wales was altered from 2.5% to -0.75%. We recognise that businesses are currently under severe financial pressure brought by the COVID-19 pandemic and, to a lesser extent, Brexit, and have cautioned, and continue to caution, against introducing a rate of -1.75% that would likely lead to further burden at this challenging time.

6. Wider societal implications must also be considered when setting a new discount rate, for example, the cost to the NHS arising from its role in clinical negligence claims and the direct impact of this on taxpayers. Furthermore, the environment created by a -1.75% discount rate may discourage (re)insurers' participation in the Northern Irish (re)insurance market, in turn impacting upon the availability of (re)insurance products.

7. In respect of the Damages (Return on Investment) Bill, we do not believe that the new methodology is the most appropriate to achieve the 100% compensation principle. Specifically, we note *Section 2, subsection 10(2)(b)* that adds an explicit 0.5% additional margin when calculating the rate. This explicit

margin will result in systematic over-compensation. We believe that this margin should be removed in order to achieve the 100% compensation principle.

8. In respect of *Section 2, subsection 20(2)*, this paragraph is agreeable if it shall only apply in the unlikely event that two permitted figures are equally near when rounding. We acknowledge that in such circumstances the nature of the rounding provision will result in an increased chance of over compensation, but understand that in all other circumstances the rate will be rounded to the nearest 0.25 percentage points.

Question 2 - Has the new methodology the potential to veer towards over compensation and if so how can this be rectified?

9. If the explicit 0.5% margin discussed above is removed, it is our view that the Bill brings forward a new methodology that will result in a discount rate enabling claimants to receive close to 100% compensation.

10. The Committee for Justice will be aware that recent rate reviews in England and Wales and Scotland that have sought to uphold the fundamental principle of 100% compensation have resulted in rates of -0.25% and -0.75% respectively. It is of particular relevance that the former Lord Chancellor incorporated an additional 0.5% margin when setting the rate in England and Wales in order to put the balance in favour of over compensation. This political decision was incredibly disappointing and will inevitably present additional costs to society in terms of increased motor insurance premiums and taxes to pay for larger medical negligence claims against the NHS. In Scotland, due to a political decision, an explicit 0.5% 'further margin' was allowed for in setting the rate to reduce the risk of investment underperformance; as previously discussed, we are aware that this approach is replicated within *Section 2, subsection 10(2)(b)*. The IUA recommends against the inclusion of the provision '0.5 of a percentage point, as the further margin involved in relation to the rate of return' that we believe will veer the methodology towards over compensation.

11. To demonstrate the significant effect that a low discount rate can have, the following was an example given in the Northern Ireland Department of Justice consultation on the 'personal injury discount rate how should it be set' (2020):

12. *'10-year-old female claimant with normal life expectancy needing £100k per annum cost of care in current values for the rest of her life. The lump sum settlement cost at the current Northern Irish discount rate of 2.5% is £3.5m. The cost would rise to £21.9m if a discount rate was set with reference to ILGs returns and a rate of -2.0% was used, an increase of 531%.'*

13. BLM Law also provided the below table illustrating a similar outcome for a 10 year old male:

Example: male aged 10 at date of award, annual life time care = £100,000			
jurisdiction	***applicable PIDR***	***whole life multiplier***	***total care award***
NI - current	*2.5%*	*34*	*£3.4 million*
NI - possible	*-1.75%*	*179*	*£17.7 million*
Eng&Wales	*-0.25%*	*87*	*£8.7 million*
Republic of Ireland	*1% (for care)*	*54*	*£5.4 m / €6m*

- The multipliers above are taken from the seventh edition of the Ogden Tables

- Projected average life expectancy of a 10 year old UK male is 78.3 years
- Figures for care costs alone and do not include general damages or other significant future loss

(Source: *BLM Law*)

14. We would also draw your attention to the Government Actuary's advice provided to the Lord Chancellor in June 2019 and, in particular, figure 1 on page 18, which illustrates that a rate as low as -1.75% will likely result in overcompensation in more than 90% of claims.

15. These points further illustrate why we believe that the Damages (Return on Investment) Bill should be progressed and brought into force as a matter of urgency.

Question 3 - Has the new methodology the potential to veer towards under compensation and if so how can this be rectified?

16. We do not think that the new methodology has the potential to veer towards under compensation. It is clear that the discount rate should be set such that claimants are as close to being 100% compensated as possible. Setting the discount rate with the assumption that a claimant would have a lower risk tolerance than a reasonably prudent and well-informed investor who would utilise a mix of low risk assets would lead to over compensation.

Question 4 - Does the new statutory methodology reflect how a claimant would be advised to invest their award?

17. With reference to *Section 2, subsection 12(3)*, as previously stated, the current investment environment would steer a reasonably prudent investor toward a low-risk, diverse investment portfolio. Our members agree that a suitable basis for setting the discount rate is with consideration of long-term average returns achievable by a reasonably prudent investor with a mixed portfolio of low risk investments.

18. It should be considered that the approach adopted within England and Wales allows a discount rate to be set based on the latest information available and supported by expert opinion. This would also be true for choosing the most appropriate asset class, rather than it being defined and rigid as is the case within the Scottish framework. However, we do acknowledge *Section 2, subsection 15(1),* which allows the Department of Justice by regulations to 'add, remove or modify an entry or any associated examples' within the first column of the table and to 'add or remove a figure' or 'modify a figure' within the second column of the table.

Question 5 - 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?

19. We agree with the approach to utilise a 43-year rather than 30-year model. Feedback in the England and Wales consultation stated that the average duration of lump sum settlements was significantly higher than 30 years.

20. Additionally, we agree with the inclusion of *Section 2, subsection 21* allowing a dual discount rate approach to be considered. Investments in the short term over, for example, 1 to 10 years often produce very different returns than investments held over more than 10 years. However, if a dualrate approach was adopted, there should be absolute certainty that two rates should apply to a claimant with a life expectancy longer than the period beyond which a different rate applies. For example, if the threshold beyond which the second rate applied was decided at 10 years, the discount rates applicable to a claimant with a life expectancy of 15 years would be one rate for the first 10 years and

a different rate for the next five years. This approach differs to the Jersey model in which the entire period will be subject to the upper rate if the life expectancy threshold, e.g. 10 years, were surpassed. We do not believe this latter approach is appropriate since a claimant with a longer life expectancy, all other things being equal, can be left with lower compensation.

21. It is worth noting that there is significantly more stability in long-term investments and, therefore, it would be a simpler process to set an equitable long-term discount rate and there would be less requirement for this long-term discount rate to be subject to regular review. A dual discount rate would be fairer for compensating individuals with different life expectancies, such as a five-year life expectancy and a 50-year life expectancy. This is not possible with a single discount rate.

Question 6 - 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?

22. With reference to *Section 1, subsection 1(4)*, the model within England and Wales has resulted in the Lord Chancellor making the ultimate decision on the discount rate. We believe that it would have been appropriate for the Minister of Justice in Northern Ireland to make the decision had the model in England and Wales been adopted. We have previously supported the decision being taken by a minister, following advice from an independent panel of experts, stating that it is important that a politically accountable minister is ultimately responsible for balancing the needs of claimants, defendants and society as a whole. Whilst we maintain that political accountability is important, we acknowledge that within the Scottish model and the proposed new methodology within the Bill, the process to set the discount rate is, broadly, an actuarial exercise and it follows that it is appropriate for the Government Actuary to make the discount rate decision.

Other Comments:

23. With reference to *Section 1, subsection 1(2)*, it is our view that this paragraph should be removed. We do not believe it is necessary to include the provision that 'does not preclude the court from taking a different rate of return into account if any party to the action shows that the different rate is more appropriate in the circumstances of the case'. Allowing courts to set rates in individual circumstances could produce legal arguments over the appropriate rate to use, as well as introduce a level of unpredictability in respect of rate setting. This could add costs, uncertainty and delays. A single rate being set would mean consistency could be applied across all courts, in all cases; this would better reflect overall economic circumstances, rather than be influenced by the circumstances of one individual case. It is our view that the discount rate should be set by the rate assessor as set out elsewhere in the Bill.

24. In respect of *Section 2, subsection 2,* we agree that the review period should be 5 years, as is the case in England and Wales and Scotland. This is frequent enough so that the discount rate should not become significantly out of line with investment returns. Additionally, it is not too frequent that it could distort settlements in the lead up to a discount rate review. It also introduces a level of predictability and thus certainty for those impacted by discount rate changes. We also acknowledge the intention of *Section 2, subsection 2(2)(i*) to align the review periods within Northern Ireland with that of England and Wales and Scotland.

25. Stability in the discount rate is important for the purposes of reserving against the liabilities of claims that have been incurred but have not yet settled and for pricing future business. Within a normally fluctuating economic environment, having set review periods should create a workable and understandable process that introduces a level of predictability. Unpredictability could lead to reduced appetite from insurers and reinsurers, ultimately leading to increased premiums for consumers.

If you have any questions or comments please do not hesitate to contact Tom Hughes (Senior Market Service Executive, International Underwriting Association) via email.