ABI

13 May 2024

Ms Joanne Bunting MLA
Chairperson
Committee for Justice
Parliament Buildings
Ballymiscaw
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By e-mail only

Dear Chair

I am writing to you in my capacity as Director General of the Association of British Insurers, which represents motor and liability insurers in the UK. Together, these firms support millions of customers and businesses and fully support ensuring that those who suffer life-changing injuries receive reasonable and appropriate compensation.

Attached is a briefing on the Personal Injury Discount Rate (PIDR), which sets out our members' perspective on the regulations in relation to the Damages (Return on Investment) Act (Northern Ireland) 2022. In summary, there is a standard adjustment to the PIDR which accounts for the cost of investment expenses and taxation to plaintiffs. In Northern Ireland, this standard adjustment is currently 0.75%. However, the proposed regulations would increase the standard adjustment to 1.25%. We believe that there is already some over-prudence in the extent to which the PIDR in Northern Ireland currently accounts for investment expenses and taxation. Further increasing the standard adjustment from 0.75% to 1.25% would move beyond the principle of 100% compensation as set out in the relevant legislation, and lead to over-compensation for plaintiffs. In doing so, it would create significant additional costs for premium paying businesses and customers in respect of motor, employers' liability and public liability premiums, as well as Health Trusts in respect of clinical negligence claims.

In addition to the proposed increase in the standard adjustments from 0.75% to 1.25%, there are also other factors which may lead to over-compensation in the setting of the PIDR in Northern Ireland:

- The relevant regulations in Northern Ireland propose that the Retail Prices Index (RPI) is replaced by Average Weekly Earnings (AWE) for calculating the impact of inflation. While we welcome the move away from RPI (as it is no longer an appropriate index to use in damages claims), it must also be noted that AWE will overstate inflation. The wording of the Damages Act 1996 suggests that it would be possible to adopt the approach used by the Government Actuary's Department (GAD) in England and Wales in the previous PIDR review: CPI + X%, which would factor out this element of over-compensation. Indeed, a plaintiff's losses can only be expected to increase over time at around CPI +0.6%.
- It is proposed to maintain the further margin adjustment of 0.5%. This reflects a policy choice to over-compensate plaintiffs, but undermines the principle that plaintiffs should not receive any more or less than

100% compensation (neither over nor under-compensation), as is provided for in the relevant legislation. It also has the consequence of creating significant additional costs for premium paying businesses and customers, as well as Health Trusts.

- The PIDR in Northern Ireland should factor in the benefit from an improved environment for investment returns, meaning low risk investors of lump sums will be able to receive higher returns. However, this improved environment for investment returns could be negated by over-accounting for investment expenses and taxation.

Taking these factors together, it is clear there is potential for the setting of the PIDR in Northern Ireland to result in significant over-compensation. This is an outcome which should be avoided if the intent of the legislation is to be preserved (namely, that plaintiffs should not receive any more or less than 100% compensation), and if significant additional costs are not to be borne as a consequence by Health Trusts and public transport operators, as well as premium paying customers and businesses.

If there is any point on which the ABI can assist further, please do not hesitate to contact [redacted] We would also welcome the opportunity to give evidence to the Committee if that would assist.

Yours sincerely

[redacted]

Association of British Insurers

Briefing on the Personal Injury Discount Rate

Executive summary

There are standard adjustments to the Personal Injury Discount Rate (PIDR) which account for the cost of investment expenses and taxation to plaintiffs. In Northern Ireland, these standard adjustments are currently 0.75%. However, the regulations in relation to the Damages (Return on Investment) Act (Northern Ireland) 2022 would increase the standard adjustments to 1.25%. We believe that there is already some over-prudence in the extent to which the PDIR in Northern Ireland currently accounts for investment expenses and taxation. Further increasing the standard adjustments from 0.75% to 1.25% would move beyond the principle of 100% compensation as set out in the relevant legislation, and lead to over-compensation for plaintiffs. In doing so, it would create significant additional costs for both Health Trusts in respect of clinical negligence claims, and premium paying businesses and customers in respect of motor, employers' liability and public liability premiums.

In addition to the proposed increase in the standard adjustments from 0.75% to 1.25%, there are also other factors which may lead to over-compensation in the setting of the PIDR in Northern Ireland:

- The relevant regulations in Northern Ireland propose that the Retail Prices Index (RPI) is replaced by Average Weekly Earnings (AWE) for calculating the impact of inflation. While we welcome the move away from RPI (as it is no longer an appropriate index to use in damages claims), it must also be noted that AWE will overstate inflation. The wording of the Damages Act 1996 suggests that it would be possible to adopt the approach used by the Government Actuary's Department (GAD) in England and Wales in the previous PIDR review: CPI + X%, which would factor out this element of over-compensation. Indeed, a plaintifft's losses can only be expected to increase over time at around CPI +0.6%.
- The regulations also propose to maintain the further margin adjustment of 0.5%. This reflects a policy choice to over-compensate plaintiffs, but undermines the principle that plaintiffs should not receive any more or less than 100% compensation (neither over nor under-compensation), as is provided for in the relevant legislation. It also has the consequence of creating significant additional costs for premium paying businesses and customers, as well as Health Trusts.
- The PIDR in Northern Ireland should factor in the benefit from an improved environment for investment returns, meaning low risk investors of lump sums will be able to receive higher returns. However, this improved environment for investment returns could be negated by over-accounting for investment expenses and taxation.

Taking these factors together, it is clear there is potential for the setting of the PIDR in Northern Ireland to result in significant over-compensation. This is an outcome which should be avoided if the intent of the legislation is to be preserved (namely, that plaintiffs should not receive any more or less than 100% compensation), and if significant additional costs are not to be borne as a consequence by Health Trusts, as well as premium paying customers and businesses.

It is also reasonable for plaintiffs to expect that their awards will be exhausted at the end of the award term. However, in practice we are not aware of any evidence of plaintiffs having exhausted their awards, whether due to investment outcomes or otherwise. This means that over-compensation in the setting of the PIDR is unnecessary.

What is the PIDR and how does it work?

The PIDR is a mechanism which aims to make sure a plaintiff receives 100% compensation (neither over nor under-compensation) when they have suffered life-changing injuries. 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 PIDR 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 plaintiffs 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 employer liability (for accidents at work) and public liability. The PIDR is also applied to Health Trust settlements for medical negligence, and by other public bodies liable in personal injury cases (such as local authorities and transport operators).

The current low PIDR in Northern Ireland (minus 1.5%) is the lowest in the world and an outlier compared to many other countries in Europe: for example, as of early 2024 the PIDR is 1% in Belgium, 1% in France, 4-6% in Germany (although there is judicial discretion), 2.5% in Norway, 2.5% in Spain, 3% in Sweden and 3.5% in Switzerland.

Implications of a low PIDR

The lower the PIDR is set, the higher the compensation settlement that is paid to a plaintiff and the greater the cost to compensators, including Health Trusts and other public bodies, as well as insurers on behalf of their customers (both individuals and businesses). Insurance underwriters need to take this into account when setting premiums for all customers, which means the lower the PIDR, the more inflationary pressure there is on liability insurance premiums. This also affects the affordability of insurance for motorists and 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 continued low PIDR in Northern Ireland would continue to put inflationary pressure on motor insurance premiums, in particular for young drivers who are at greater risk of being involved in an accident.

Health Trusts in Northern Ireland are also significant compensators for settlements involving discount rates, usually in clinical or medical negligence cases. A continued low PIDR in Northern

Ireland which results in over-compensation would mean that Health Trusts need to reserve a higher amount of funds against future claims.

Our concerns with the proposed standard adjustments in the regulations

There are standard adjustments to the PIDR which account for the cost of investment expenses and taxation to plaintiffs. In Northern Ireland, these standard adjustments are currently 0.75%. However, the regulations in relation to the Damages (Return on Investment) Act (Northern Ireland) 2022 would increase the standard adjustments to 1.25%.

We believe that there is already some over-prudence in the extent to which the PIDR in Northern Ireland currently accounts for investment expenses and taxation. Most properly advised plaintiffs will pay very little tax over the long-term. This is because, over the long-term, investment in various tax wrappers will mitigate income and capital gains tax risks. Indeed:

- Most of those whose personal injury claims are subject to the PIDR are either non or basic rate taxpayers.
- By investing the monies in different tax wrappers (for example, insurance company bonds/collectives and ISAs, where appropriate), income and capital gains tax is greatly mitigated.
- In some years there is no tax to pay.
- Any tax liability will also be reduced over time as withdrawals are made from the fund.
- Where relevant, substantial income can be paid free of income tax via a periodical payment order (PPO). This is an alternative to a lump sum for damages.

While a case could be made for a higher adjustment for taxation in a higher interest rate environment, when considering the impact of economic factors such as interest rates, it is essential that there is only a focus on long-term (not short-term) trends. Interest rates need to be considered over the long-term, i.e. 43 years to reflect average periods of loss for injured plaintiffs. It is not likely that the current high interest rate environment will continue over this time period, and interest rate cuts are already widely anticipated in 2024.

It is also the case that overall, higher taxes and investment expenses are associated with more active investment approaches which should generate higher net returns. However, recipients of personal injury compensation, as low risk investors, are assumed to take a passive investment approach in line with their lower appetite for investment risk. Given the low levels of risk that are assumed for a plaintiff, there will be limited management of the long-term fund and so investment fees can be kept relatively low (and within the range allowed by the Government Actuary's Department (GAD) in the previous PIDR review).

Our view is therefore that there is already some over-prudence in the extent to which the PIDR in Northern Ireland currently accounts for investment expenses and taxation. **Further increasing the standard adjustments from 0.75% to 1.25% would move beyond the principle of 100% compensation as set out in the relevant legislation, and lead to over-compensation for** plaintiff**s. In doing so, it would create significant additional costs for Health Trusts in respect of clinical negligence claims, and premium paying businesses and customers in respect of motor, employers' liability and public liability premiums.**

The need to avoid over-compensation

In addition to the proposed increase in the standard adjustments from 0.75% to 1.25%, there are also other factors which may lead to over-compensation in the setting of the PIDR in Northern Ireland:

1. The relevant regulations in Northern Ireland propose that the Retail Prices Index (RPI) is replaced by Average Weekly Earnings (AWE) for calculating the impact of inflation. While we welcome the move away from RPI (as it is no longer an appropriate index to use in damages claims), it must also be noted that AWE will overstate inflation. The benefit in applying RPI for the previous PIDR review was that it was tracking at around CPI + 1%. This reflected (in GAD's view) a midpoint between CPI and earnings inflation, and therefore represented an appropriate index that neither over nor underestimated inflation. GAD has noted in their report[1] as follows:

   We note that the legislation in Northern Ireland requires a single, unadjusted, published index to represent damages inflation. Therefore, options such as making an adjustment to CPI ie CPI + X%, the publication of a bespoke index or using the further margin to adjust for inflation were deemed to be not possible under the legislation and have not been considered further.

   We have considered the wording of Schedule C1 to the Damages Act 1996. It is not clear to us why it is considered that the legislation requires a single, unadjusted published index to represent damages inflation. The legislation states:

   The impact of inflation is to be allowed for by reference to, whether indicating an upward or downward trend—

   (a) the retail prices index, or

   (b) some published information relating to costs, earnings or other monetary factors as is, for use instead of the retail prices index, prescribed in regulations made by the Department of Justice.

   The words 'by reference to' suggest that it would be possible to adopt the approach used by GAD in England and Wales in the previous PIDR review: CPI + X%. This would represent an outcome closer to a midpoint between CPI and earnings, which ensures that there is no over or underestimate of inflation. Applying a rate at CPI + X% (instead of applying AWE) would factor out this element of over-compensation.

   In advising the Department of Justice in Northern Ireland, GAD provided illustrative ranges for AWE at CPI +1.5% – +1.8% (based on its in-house pensions valuation advisory guidance and OBR data as at July 2022). However, we commissioned expert evidence which concluded that if 50% of losses are price-related and 50% wage-related (as was assumed by GAD in its 2019 report to the Lord Chancellor[2]), a plaintiff's losses can only be expected to increase over time at around CPI +0.6%. (This advice is based on a midpoint between ASHE (real wage growth forecast at 1.2% a year) and CPI. The advice that we have received looks at ASHE and AWE and concluded, contrary to GAD's recommendations, that ASHE should in fact be the preferred index. For personal injury practitioners, ASHE is already the index that they are used to applying as earnings related periodical payments are linked to it).

[1] Personal Injury Discount Rate regulation features advice – Northern Ireland, 27 March 2024
[2] Setting the Personal Injury Discount Rate: Government Actuary's advice to the Lord Chancellor, 25 June 2019

2. The regulations in Northern Ireland propose to maintain the further margin adjustment of 0.5%. This is designed to reduce the risk of under-compensation and so reflects a policy choice to over-compensate plaintiffs. However, the further margin adjustment undermines the principle that plaintiffs should not receive any more or less than 100% compensation (neither over nor under-compensation), as is provided for in the relevant legislation. It also has the consequence of creating significant additional costs for premium paying businesses and customers, as well as Health Trusts, and is unnecessary because significant layers of prudence are already built into discount rate modelling by GAD.

   Should the reference to AWE be retained as the inflation index, it is clear that inflation will be overestimated which will lead to over-compensation – therefore compounding the level of over-compensation caused by the further margin of 0.5%.

3. The PIDR in Northern Ireland should factor in the benefit from an improved environment for investment returns, meaning low risk investors of lump sums will be able to receive higher returns. Indeed, we commissioned expert evidence which shows that plaintiff financial advisers are able to achieve very favourable investment returns for their clients. These are considerably better than those anticipated when setting the current low PIDR in Northern Ireland. A commensurately higher PIDR would help to reduce the pressure on Health Trusts in respect of clinical negligence claims, and the pressure on motor, employers' liability and public liability premiums. However, an improved environment for investment returns could be negated by over-accounting for investment expenses and taxation.

Taking these factors together, it is clear there is potential for the setting of the PIDR in Northern Ireland to result in significant over-compensation. This is an outcome which should be avoided if the intent of the legislation is to be preserved (namely, that plaintiff**s should not receive any more or less than 100% compensation), and if significant additional costs are not to be borne as a consequence by Health Trusts, as well as premium paying customers and businesses.**

It is also reasonable for plaintiffs to expect that their awards will be exhausted at the end of the award term. However, in practice we are not aware of any evidence of plaintiffs having exhausted their awards, whether due to investment outcomes or otherwise. This means that over-compensation in the setting of the PIDR is unnecessary.

The investment period in Northern Ireland

The ABI welcomes the retention of the 43 year investment period in Northern Ireland. However, it is important that the modelling applied in calculating the PIDR reflects real-world rates of return over a 43 year period. We have previously made representations that reference should be made to wide-ranging market studies, such as the Barclays Equity Gilt Study, to ensure that real-world outcomes are applied.

Examples of the effect of the PIDR on compensation settlements

The following illustrative only case studies show theoretical lump sums at several different discount rates. These demonstrate that even minor changes in the PIDR can significantly affect the level of compensation and therefore, the prospect of achieving the aim of 100% compensation (neither over nor under-compensation).

The case studies show theoretical lump sums at the following discount rates: 2.5%, 2%, 1.5%, 1%, 0.5%, 0%, -0.25% (the current PIDR in England and Wales), -0.5%, -0.75% (the current PIDR in Scotland), -1%, -1.5% (the current PIDR in Northern Ireland) and -2%. The calculations make use of the updated 8th Edition Ogden tables, provided by GAD.

It should be noted that the case studies are simplified examples which only model damages for cost of care and loss of earnings and are intended to be illustrative and not definitive. They do not attempt to take account of awards made in respect of lost pension contributions or varying employment income over the plaintiff's lifetime. Nonetheless, the case studies demonstrate that even minor changes in the PIDR can significantly affect the level of compensation and therefore, the prospect of achieving the aim of 100% compensation.

Example 1: A 25-year-old male is severely disabled in a car accident and cannot work again. He is employed, has a degree and it is determined he would have earned a net figure of £25,000 a year until retirement at 67. His cost of care is going to be £150,000 a year for the rest of his life. His stated life expectancy is 70.

PIDR	Lump sum
Minus 2%	£12,410,178
Minus 1.5% (current PIDR in Northern Ireland)	£10,920,343
Minus 1%	£9,655,665
Minus 0.75% (current PIDR in Scotland)	£9,095,591
Minus 0.5%	£8,578,688
Minus 0.25% (current PIDR in England and Wales)	£8,100,152
0%	£7,657,953
0.5%	£6,868,685
1%	£6,188,065
1.5%	£5,602,273
2%	£5,091,943
2.5%	£4,650,089

Example 2: A 42 year old man is severely injured in an accident and can now only do sedentary work. He was employed and has A-levels. He would have earned a net figure of £27,500 per year until retirement at age 68, but can now expect to earn £7,500. The cost of care will be £13,500 per year.

PIDR	Lump sum
Minus 2%	£1,531,356
Minus 1.5% (current PIDR in Northern Ireland)	£1,369,242
Minus 1%	£1,231,263
Minus 0.75% (current PIDR in Scotland)	£1,169,817
Minus 0.5%	£1,113,021
Minus 0.25% (current PIDR in England and Wales)	£1,060,122
0%	£1,011,063
0.5%	£922,881
1%	£846,315

1.5%	£779,397
2%	£720,390
2.5%	£668,562