



Forum of Scottish Claims Managers (FSCM) response to Consultation Paper:

Damages Act 1996: The Discount Rate

Review of the Legal Framework (second Discount Rate Consultation)

<http://www.fscm.org.uk>

Section 1 Who are the Forum of Scottish Claims Managers and who do we represent?

Section 2 Consultation Response Document



About the Forum of Scottish Claims Managers (FSCM)

The Forum exists as a lobbying organisation on behalf of its members and to represent their interests in the handling of insurance claims.

1. The Forum aims to promote improvements to the law to enable consumers easier and quicker access to justice.
2. The forum membership covers a number of major insurers, financial institutions together with claims handling companies and Local Authorities.
3. The individual members of FSCM are all senior professionals being Claims Managers or equivalent within their respective organisations with a wealth of experience in Insurance claims matters.
4. To provide some context of the size and scale of our membership:
 - We directly employ approximately 5,550 people in Scotland, solely in insurance
 - We generate over £1.9 billion annually in respect of insurance premiums collected in Scotland (Personal and Commercial business premiums)
 - Solely on claims, we spend £1.257 billion annually in Scotland
 - Glasgow is the largest insurance centre in the UK, outside London and is seen as core pool of talented resources
5. Insurance companies exist to provide financial protection for consumers and businesses in the event that the unforeseen happens.

It is the Forum's desire to be actively engaged, with all interested parties, in discussions and debate relating to Third Party claims** in Scotland including Pre and Post-litigation.

Alan Rogerson
Vice Chairman of the Forum of Scottish Claims Managers

Aviva Insurance
139 West Regent Street
GLASGOW
G2 2SG

 Tel: 0141 301 3122
 Mobile: 07800 691465
 Alan.Rogerson@Aviva.co.uk

<http://www.fscm.org.uk>

**** Third Party Claims definition:**

Personal Injury or damage to Property arising out of a party's negligence – be it a personal (Consumer) matter or a Commercial (Business) matter, Road Traffic Accidents and accidents in the Workplace

Further information on the Forum of Scottish Claims Managers (FSCM)

Membership:

ACE European Group Ltd Allianz Aviva Direct Aviva Insurance AXA Chartis Churchill Direct Line Eagle Star Direct Esure Equity Red Star Halifax Liverpool Victoria More Than NFU Mutual NIG	Pearl Privilege Prudential PSV Claims Bureau Ltd QBE RAC Insurance Royal & Sun Alliance Travelers Insurance UKI Insurance Zurich Municipal Zurich Insurance Plc Glasgow City Council North Lanarkshire Council Motor Insurers Bureau
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We would welcome responses to the following questions set out in this consultation paper, either generally or specifically in relation to one or more of the jurisdictions in the United Kingdom. In providing your responses to these questions, it would be helpful if you could include any analysis or evidence you have to support your responses, drawing on experience of other sectors or countries as appropriate.

General issues

Question 1: do you agree that the general principles of:

- accuracy
• transparency and simplicity, and
• stability

should be used to assess the appropriateness of proposed solutions?

[X] Yes [] No

If not, please give reasons.

The Forum of Scottish Claims Managers (FSCM) agree that the general principles of accuracy, transparency, simplicity and stability should be used to assess the appropriateness of proposed solutions, however there is a balance to be struck between these, when they could be construed as competing factors. In terms of accuracy, our acceptance of these general principles is premised on the same understanding of 'Accuracy' as defined in paragraph 21 of the discussion paper as: Accuracy: the rate should provide as accurate as possible a reflection of the return on investment the hypothetical claimant should reasonably be expected to make to ensure so far as possible that the claimant is not under-compensated or over-compensated by virtue of the opportunity to invest the monies received until they are intended to be spent in accordance with the terms of the award. This definition implies that the methodology for accuracy will still have to be a broad framework for a hypothetical claimant rather than a bespoke and complicated arithmetical approach which is a view we share and endorse. The overwhelming test of appropriateness of a proposed solution has to be that claimant should not receive a sum of money greater than is required to put the claimant back in the position they were but for the incident.

Question 2: do you agree that accuracy is the most important of these three general principles?

[] Yes [X] No

If not, please give reasons.

We do not believe that any one of these general principles overrides the others as being more important than the others. Each general principle has its place in that accuracy as defined in paragraph 21 is an important principle, but equally so is having a mechanism which is transparent and relatively simplistic in approach. Accuracy should not be sought to the detriment of the other factors, especially when we are considering matters with future imponderables which may be impossible to factor in. It is also important to consider what actual claimants do with their compensation. In other words, to arrive at a holistic view of what a hypothetical claimant will do, it is possible to look at what actual claimants have done with their awards, what level of risk they have adopted within their investment portfolio and what rates of return they have achieved.

Question 3: are there any other issues relating to the setting of the discount rate and the possible encouragement of the use of periodical payments that you would wish to draw to our attention? Please give reasons.

The experience of our members is that the vast majority of claimants pursuing high value claims still choose a lump sum award as opposed to a periodical payment order.

This has to be indicative that lump sum awards are appropriate and with investment advice, can achieve rates of return better than the current discount rate of 2.5%.

We are aware that other submissions will provide you with proper evidence on such custom and practice for investment rates of return, so do not propose to reiterate the fine detail here. Instead we would defer to the expert evidence submitted as part of the consultation exercise by the ABI and individual insurance companies.

Periodical Payments were introduced:

- 1) to make sure claimants were properly compensated so as to ensure their annual (principally) care and case management costs were met throughout their lifetime
- 2) to counter any potential rate of increase of claims inflation, particularly the long term cost of care and case management

However, the suppression of wages as a result of the economic downturn has resulted in annual payments for care and case management over the last couple of years actually being progressively lower, reflecting the reduction in earnings for care workers and case managers.

Periodical Payments remain a risk free method of achieving compensation certainty in the most catastrophic of injury cases and we believe if lump sum awards were truly not working for the majority of claimants, we would experience a rise in the numbers of claimants seeking periodical payments.

Discount rate

Question 4: do you consider that the legal parameters governing the setting of the discount rate should be changed?

Yes No

Please give reasons.

We believe the notion of the special sub-category of prudent investor with a lower risk appetite simply bears no relation to actual custom and practice of what occurs when the claimant comes to investing their award of damages for the future as recognised in *Warriner v Warriner*.

The most catastrophically injured claimants can choose certainty with no level of risk through periodical payments and guarantee their compensation will be sufficient to provide for their future care and needs.

The reality is that claimants do better with their money elsewhere than investment in ILGS and as submitted previously, it is highly unlikely that a claimant will invest solely in ILGS and hold them until maturity.

The legal parameters should be re-considered in light of what actually occurs in practice.

Question 5: if you consider that the legal parameters governing the setting of the discount rate should be changed, what do you think they should be? Please give reasons and define any terms used.

Section 1(1) of the Damages Act 1996 places a duty on the Court to determine "a rate of return to be expected from the investment of a sum awarded as damages for future pecuniary loss".

We submit that the approach previously taken in *Wells v Wells* needs to be re-appraised given that claimant investors should be not taken as a special sub-category of investor when the reality is that they do invest in a mixed portfolio of investments and secure a rate of return in excess of 2.5%.

The issue identified originally in *Wells v Wells* where a claimant who does not have capacity could be unfairly disadvantaged through a lump sum award has been remedied by the availability of periodical payments.

Question 6: if you consider that the legal parameters governing the setting of the discount rate should be changed, what investments do you think the hypothetical claimant should be deemed to make for the purposes of calculating the rate of return? Please indicate the types and proportions of assets that should be included in the hypothetical claimant's portfolio of investments. Please give reasons.

We would firstly refer to the practice of the Court of Protection in the UK which uses what is known as a traditional long term fund made up of 10% cash, 30% bonds and 60% equities.

In our original consultation response, we were able to refer to evidence that the majority of claimants invest in a 70/30 Gilt/Equity portfolio.

One of our members has commissioned research on the potential rates of return from such a low risk strategy and we understand the evidence will accompany their own consultation response.

Their expert, Mark Quilter reports that a conservative estimate of return (excluding tax and management fees) is as follows based on a 70/30 Gilt/Equity split:

- Year 1 to 5 - 4.5% Cash/Gilts
 - 4.5% Equities
 - 4.5% Alternative Assets
- Year 5 to 20 - 4.7% Cash/Gilts
 - 8.0% Equities
 - 5.7% Alternative Assets

Interest rates have remained at 0.5% and are forecast to remain low in the short term. The Government has also confirmed that ILGS will remain linked to the Retail Price Index (RPI), and the general consensus is that RPI inflation will continue to run at 3% for the foreseeable future. Since December 2012 equity markets have had a extremely good run and are at a 5 year high. These factors suggest that higher investment returns will be available than this conservative forecast.

As the economic climate recovers, the rate of return will also improve.

At the moment there are opportunities for claimants to invest in very low risk but high return deposit accounts or structured products such as Meteor FTSE Investment Plan (6% pa return indicated) and Cater Allen Private Bank (3.7% pa, 3 year fixed term deposit account) and 5 and 6 year investment bonds where the capital is protected and there are potential returns of 50% over that period. For example, the Royal Bank of Scotland offers a 6 year UK Growth accelerated deposit plan with a target return of 45%. With the benefit of investment advice, there is every reason to anticipate the average personal injury claimant taking advantage of these low risk high yield investment opportunities.

Question 7: do you consider that the availability of periodical payments should affect the level at which the discount rate is set?

Yes No

Please give reasons and indicate what effect you think it should have.

When the House of Lords decided *Wells v Wells*, it was against the backdrop that periodical payments and the certainty and security for claimants lacking capacity was in direct focus, directly relevant and a real issue which had to be addressed.

The landscape has now changed and as answered elsewhere, periodical payments provide the safety net and secure and certain method of settlement for such cases so they are no longer a necessary factor when considering setting the discount rate.

Question 8: should the court have power to depart from the prescribed rate?

Yes No

If so, should the terms on which it may do so be expressly defined?

Yes No

Please specify the terms and give reasons.

We do not believe that the court should have the power to depart from the prescribed rate as to do so would open the discount rate and mechanism for setting same up to scrutiny in each and every case.

As answered previously, there is a balance to be struck between the various factors of accuracy, transparency and simplicity.

Allowing the court to depart from the prescribed rate would only serve to undermine the entire process and discount rate mechanism.

Question 9: should the power to prescribe different rates be available for:

- | | | |
|--|------------------------------|--|
| a. different classes of case? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| b. different periods of time over which damages are paid? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| c. different heads of damages? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| d. cases where periodical payment orders are available and where they are not? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

If so, for which classes, periods or heads would you specify different rates? Please give reasons.

There should be only one rate for simplicity and transparency reasons.

To have different rates would only serve to create uncertainty, confusion and satellite litigation.

Having different rates for different heads of claim or periods would also lead to increased court time in having to deal with these issues of uncertainty and satellite litigation.

As stated previously, arithmetical accuracy should not be pursued to the detriment of other factors.

Question 10: if you consider that the legal base for setting the rate should be changed, what methodology should be used to set the rate, including:

- what quantitative and qualitative data should be used (e.g. historic or forward looking, specific indices)?
- what assumptions should be made (e.g. asset mix, weighting of assets)?
- how should inflation be taken into account?
- what allowances should be made for tax, administration or management expenses and investment expenses?

Please give reasons.

It is outwith our area of expertise to comment in detail on the exact methodology to be used to set the rate.

However, we would submit that such a matter is very complex and would have to be a mixed approach of balancing historic data with forward looking predictions. To focus too heavily on any one area would only serve to skew the discount rate and not achieve a relevant or correct outcome.

We would refer to previous answers regarding what actual personal injury claimants do with their awards - how awards are actually invested for the future, the asset mix they contain and the rates of return that they receive are all valid factors which must be taken into account.

We would submit that no allowance should be made for investment expenses because these are deducted from the net yield on the returns of the portfolio as a percentage rather than fixed – this was confirmed by the expert evidence of Mark Quilter which accompanied our original consultation response and indeed, other original consultation responses.

The cases of *Eagle v Chambers* 2004 and *Page v Plymouth Hospitals* 2004 both establish that the cost of investment advice is not recoverable, and in fact, when setting the discount rate, the Lord Chancellor or Scottish Ministers have always set the rate to reflect the net rate of return after Tax and Management or transaction charges.

Periodical payments

Question 11: do you consider that the present level of usage of periodical payments is appropriate and that no change is necessary?

Yes No

Please give reasons.

The evidence from our members is that where a claimant seeks a periodical payment order in England and Wales, the court will invariably make one.

Our main focus is understandably Scotland and the civil law of damages in Scotland where at present the mechanism for periodical payments is available given the case of *D's Parent & Guardian v Greater Glasgow Health Board* 2011 where Counsel included a framework or blueprint for such agreements which was subsequently endorsed by Lord Stewart in his judgement.

At the moment, periodical payments can only be used with consent from both parties and court approval.

We believe the Scottish Courts should have the power to recommend periodical payment orders to parties, but only in cases of catastrophic injury claims where the claimant lacks capacity.

PPOs should not be viewed as a replacement for traditional lump sum awards in the majority of cases, but as stated, should be a framework available to the courts to ensure justice is fair and reasonable.

We would submit that the fact that there has only ever been one case in Scotland where a periodical payment order has been sought is factual evidence that lump sum awards are better serving injured claimants and that the current discount rate must be more than adequate to meet the needs of the injured claimant.

Question 12: if you consider that the present level of usage of periodical payments is not appropriate and that change is necessary, please indicate the measures that you think should be taken to increase their use. Please give reasons.

N/A

Question 13: do you consider that claimants and defendants are sufficiently informed about the availability of periodical payments and how they operate?

Yes No

Please give reasons.

Yes, we believe there is sufficient information about availability and how periodical payments operate within both the claimant and defendant arenas, even in Scotland.

Question 14: why are periodical payment orders not used in a larger proportion of cases? Are there, for example, types of cases where periodical payment orders are not appropriate? Or are there particular costs, obstacles, risks or circumstances which limit the use of periodical payment orders?

This is essentially a question for the claimant community. We can only assume that periodical payments are not sought in greater numbers because lump sum awards are sufficient and provide adequate levels of compensation, that with proper advice and investment, will continue to meet the claimant's requirements.

We submit that periodical payments are only really suited to the most catastrophically injured claimants where they lack capacity and provide the certainty required where a full time care regime is required - examples being tetraplegics, significant brain injured patients or in a persistent vegetative state.

In our experience, claimants prefer the flexibility of a lump sum award so they have the freedom to choose how to manage their own financial affairs.

Question 15: where periodical payments are used in conjunction with a lump sum, what determines the balance between the lump sum and the periodical payment elements of the overall award of damages?

The periodical payment element is to provide certainty of funding for the future losses where the level of costs in the future may be uncertain such as care costs and case management.

The lump sum element will be the past losses or the components that are easily quantifiable.

This is not an area which causes any dubiety or disagreement.

Question 16 [Scotland only]: do you consider that there would be merit in reviewing the existing approach to periodical payments in Scotland? If so, please give reasons.

The mechanism for periodical payments is readily available in Scotland given the case of D's Parent & Guardian v Greater Glasgow Health Board 2011 where Counsel included a framework or blueprint for such agreements which was subsequently endorsed by Lord Stewart in his judgement.

At the moment, periodical payments can only be used with consent from both parties and court approval.

We believe the Scottish Courts should have the power to recommend periodical payment orders to parties, but only in cases of catastrophic injury claims where the claimant lacks capacity.

PPOs should not be viewed as a replacement for traditional lump sum awards in the majority of cases, but as stated, should be a framework available to the courts to ensure justice is fair and reasonable.

Impact Assessment

Question 17: do you agree with the impact assessment that accompanies this consultation paper?

Yes No

If not, please give reasons.

On this question, we would concur with the views expressed by the ABI in their response.

In Option O it is noted that the costs and benefits are measured against themselves they are necessarily zero. Option 1A and 1B then reflect a change in the parameters used to set the discount rate that result in the rate being either increased or reduced. There is no consideration of a change in the parameters that results in the rate remaining as it is currently set.

Policy Option 1: Change the parameters used to set the discount rate to reflect a mixed portfolio of financial assets. The Impact Assessment does not address the issue of indemnity levels if the rate were reduced. This would have a direct impact on public and employer liability insurance holders as the level of indemnity on their policy would probably be insufficient.

Under "Other key non-monetised benefits by main affected groups" for Option 1B it states "there may be benefits to wider society in terms of equity (fairness) if this proposal reduces the level of over-compensation". The effect of reducing the discount rate would be that claimants receive significantly higher compensation awards. That is unlikely to be of any benefit in addressing perceived over-compensation.

Paragraph 1.29 and 1.35: The ABI would encourage the Government to complete a comprehensive and wide-ranging study into what claimants do with their compensation awards. This should be completed before policy decisions are taken on the future of the current rate.

Policy Option 2: Encourage greater use of PPOs. Increased use of PPOs would create issues for insurers. We have dealt with this in our response to question 3. In brief issues for consideration that are not mentioned in the IA are as follows:

- Currently firms writing long term business are allowed to take into account the illiquid nature of their liabilities by adding the so called "liquidity premium" to their discount rate. This applies irrespective of whether it is a life or a non-life firm so long as the application of the liquidity premium does not compromise the market consistent framework.
- Compared to Solvency I and ICA, Solvency II will be more prescriptive in relation to reserving and capital requirements for PPOs. Insurers will be required to discount future cash flows from PPOs in line with the risk-free interest rate term structure and possibly with a matching adjustment as determined by European Regulation. There will also be higher capital requirements.
- Solvency II will require insurers to hold a risk margin in their balance sheets equal to the present value of the cost of capital required to run off their PPO liabilities. This can be substantial for PPOs with a tail of 50 to 60 years or more.

- The impact of Solvency II combined with an increased uptake in the number of PPO settlements is likely to have a significant effect on the behaviour of insurance companies, investors, reinsurers and regulators with likely impacts on the run-off and life industries. The long term liability inherent in a PPO and the lack of a safety net for insurers on reinsurer default inevitably causes the mean term of reserves to increase meaning that insurers have more exposure to investment markets and general economic forces – making them more hedge fund than general insurer.
- Larger reserves will require more capital to back them either raised from investors or from retained profits. This will have a significant impact on smaller insurers and even insurers without any PPO liability as they will need to retain capital 'just in case'. It is also likely to lead to significant increases in insurance premiums.
- If an insurer has even one PPO claim it could be impossible to sell. This is likely to deter investment in new entrants to the motor market adversely affecting competition and the efficiency of the market. The stringent capital and reserving requirements for PPOs may invalidate some business models currently used by smaller insurers and impact the M&A market.

In paragraph 2.49 it is noted that the NHSLA use PPOs more frequently than other defendants. That is likely to be due to the fact that many of the NHSLA's cases will involve protected parties, for whom a PPO is often the most suitable option. In addition, unlike insurers, any PPOs settled by the NHSLA can be funded by future taxation reserves.

In paragraph 2.72 it is assumed that lump sum and PPO represent the same overall award for compensation. There is no way of knowing that at present and will not be known for many years to come given the uncertainty surrounding mortality and inflation.

Question 18: do you have any information regarding:

- the effect of the current discount rate on the size of awards of damages and as to the likely effect of a change in the rate on the size of awards in the future;
- on whether awards made under the present law turn out to be inadequate;
- on the reasons why periodical payments are used;
- the effect of periodical payments on the overall long-term total cost of awards;
- or on any other issues relevant to the assessment of the impact of the proposals under consideration?

If so, please could you provide details.

We do not have any evidence to offer at this stage

Question 19: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would affect the behaviour of businesses or voluntary sector organisations?

Yes No

If so, please give reasons.

If the discount rate is reduced, in simple terms, insurers will have to pay higher levels of compensation. This additional cost of compensation is ultimately borne by consumers and businesses through higher insurance premiums which would have to be paid.

There is also the issue over indemnity limits on insurance policies being stretched and the availability and affordability of insurance cover with higher indemnity limits.

This could in turn restrict the operations of the voluntary sector who cannot pass on increased costs the way businesses can through higher prices and therefore affect the availability and affordability of insurance cover for their activities or the extent of the activities they undertake.

Small Firms

Question 20: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would have any direct affect on small or micro-businesses?

Yes No

Please give reasons.

Small firms would be affected in the same way we outline in our answer to Question 19

Question 21: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments must apply to small and micro-businesses as it applies to others?

Yes No

If not, please give reasons.

The approach, level of encouragement and methodology must be the same regardless of the size of businesses involved otherwise a change in approach would lead to manifest unfairness of justice.

Equalities impacts

Question 22: do you agree with the initial assessment of the equalities impacts of the possible changes under discussion in this consultation paper?

Yes No

If not, please give reasons.

N/A

Question 23: if you consider that the changes under consideration in this consultation paper in relation to the discount rate or the use of periodical payments will affect people with different protected equality characteristics please give reasons and provide evidence of any ways in which this will occur.

N/A

About you

Full name	Alan Rogerson
Job title	Chairman
Capacity in which you are responding to this consultation exercise (select all which apply)	Legal representative: <input type="checkbox"/> claimant/plaintiff/pursuer <input type="checkbox"/> defendant/defender <input type="checkbox"/> Insurer <input type="checkbox"/> Judiciary <input type="checkbox"/> Financial institution <input type="checkbox"/> Academic <input type="checkbox"/> Public sector body <input type="checkbox"/> Business <input type="checkbox"/> Equality group <input type="checkbox"/> Member of public <input checked="" type="checkbox"/> Other - Representative body of Insurers, Local Authorities and Claims Handling Companies who operate in Scotland
Date	07/05/2013
Company name/organisation (if applicable)	Forum of Scottish Claims Managers
Address	139 West Regent Street Glasgow
Postcode	G2 2SG
<input type="checkbox"/> If you would like us to acknowledge receipt of your response please tick this box (emailed responses will be acknowledged automatically).	
Address to which this acknowledgement should be sent, if different from above	

Please post the completed questionnaire to:

Damages Discount Rate Consultation
Ministry of Justice
Post Point 6.21
102 Petty France
London SW1H 9AJ

Alternatively, please email it to: damagesdiscountrate@justice.gsi.gov.uk