



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

### **Damages Act 1996: The Discount Rate**

#### **How should it be set?**

<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](mailto: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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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.

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.

**Option 1 – ILGS based approach**

**Question 1:** Do you agree that the claimant should be assumed to hold all ILGS until redemption?

Yes     No

If not, what alternative assumption would you make? Please give reasons.

We do not agree that the Claimant should be assumed to hold all ILGS until redemption.

The experience of our members is that the majority of claimants who opt to settle with lump sum awards, then go on to invest such awards in a balanced portfolio through a specialist financial advisor rather than any one investment vehicle.

We would refer to the Appendix to the ABI submission to the Consultation containing the report from Mr Mark Quilter who is a specialist Investment Advisor/Manager.

The report from Quilter confirms the basket of equity approach to investment by the vast majority of claimants:

Number of Clients managed by Charles Stanley PI & Damages Awards Team			
	Asset Allocation	Acceptable level of Risk	Clients
CO1	100% Cash Investment	Medium - Low	71
CO2	Up to 30% Equity	Medium - Low	74
CO3	Up to 50% Equity	Medium/Balanced	72
CO4	Up to 70% Equity	Medium/Balanced	121

Our information and expert advice given to our members on individual cases they see on a regular basis suggests that Claimants trade in ILGS as a component part of their investment strategy rather than holding on to them until redemption.

If the claimant wishes to avoid the balanced portfolio method, then there is the alternative of Periodical Payment Orders. Even in Scotland, where there is no statutory mechanism for PPOs, they can be arrived at through agreement and indeed, there is court authority for same in the case of *D’s Parent & Guardian v Greater Glasgow Health Board 2011* where Lord Stewart said:

*“Lawyers who fail to address merits of compensation by periodical payments could now be liable in professional negligence for resulting losses”*

The logical conclusion is that the current mechanism for arriving at lump sum awards must work and must perform to adequately compensate, or more Claimants would be advised to seek Periodical Payment type settlements.

**Question 2:** By reference to what ILGS yields should the discount rate be set? Please give reasons.

The view of our members is ILGS yields should not be used at all for the reasons set out in our answer to question 1 and the report from Oxford Economics (within the Appendix to the ABI submission to the Consultation) highlights the considerable volatility in the pattern of yields over the past 3 years which is contrary to the rationale in *Wells v Wells* adopted by the Lord Chancellor in 2001 which assumed a relatively stable rate of return under affected by outside factors.

We would also suggest that assessing the yield over a period of three prior years, would not give a dependable prediction for long term rates of return.

Indeed, an assessment at this period in time, given the 3 year history of market volatility would not give an accurate forecast for the future in any way and may actually give a grossly distorted forecast.

**Question 3:** What range of ILGS yields should the discount rate be based on and what calculation should be applied to them? Please give reasons.

The answer we give to question 2 serves to illustrate the problem of using ILGS rates at all, and we do not believe they should be used.

Indeed, in practice, claimants do not tend to invest in ILGS and the ILGS market does not necessarily match the claimants requirements for the period of investment together with issues over lack of availability of long term ILGS

**Question 4:** Should any allowance be made for potential differences between RPI inflation and health care costs inflation? Please give reasons.

No.

The Court of Appeal considered health care costs specifically in the case of *Thompstone v Tameside and Glossop NHS Trust* in 2007 and confirmed the use of ASHE 6115 as the appropriate measure rather than the RPI.

To introduce an alternative calculation/factor within the discount rate would be entirely wrong and detract from the very basis of the mechanism.

The Court of Appeal considered protecting claimants against inflation in *Wells v Wells* and ruled that to try to do so would impose “*an excessive burden, which may go far beyond compensation for loss*”.

If a claimant was concerned that inflation would render their settlement inadequate to fund future care costs, they have they option of seeking a PPO settlement based on ASHE 6115 and achieving protection against wage inflation.

Again, the certain fact that few claimants seek PPO settlements and lump sum awards are the norm, suggests that healthcare costs inflation is not a relevant factor or consideration in many cases.

**Question 5:** What considerations should be applied to the rounding up or down of the discount rate? Please explain your reasons.

We would simply suggest that the discount rate be set in rounded increments to ensure ease of use and avoid additional uncertainty

**Question 6:** Should the rounding of the discount rate be restricted to one half per cent? If not, what degree of rounding would be appropriate? Please give reasons.

See above answer to Question 5 – for simplicity of calculation and the use of the Ogden Tables the rounding should be left at 0.5%

**Question 7:** What allowance should be made for investment expenses and tax? Please give reasons.

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 – confirmed in the report of Quilter. (within the Appendix to the ABI submission to the Consultation)

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.

## **Option 2 – mixed portfolio applied to current data**

**Question 8:** Do you agree that setting the discount rate on the basis of the expected return from a mixed portfolio of assets is in principle consistent with the decision of the House of Lords in *Wells v Wells*?

Yes     No

Please give reasons.

The overriding principle set out in *Wells v Wells* is that the claimant must obtain full compensation and should be neither under or over compensated. This then gives justice to both claimant and defender alike.

The use of a mixed portfolio of investments will meet this requirement.

**Question 9:** If option 2 is adopted, what should the mixed portfolio of assets on which the calculation of the discount rate is to be based contain? Please indicate the type and proportions of assets to be included and give reasons for your choice.

The Court of Protection in the UK uses what is known as a traditional long term fund made up of 10% cash, 30% bonds and 60% equities.

The APCIMS (Association of Private Client Investment Managers and Stockbrokers) issues regular indices on fund performance. The 183 members manage over £475 billion in total.

Their indices for 3 common mixed portfolios are:

Cash/Gilts	Equity	Benchmark	5 year returns	10 year returns
70%	30%	Composite Index	20.21%	72.34%
50%	50%	APCIMS Income	16.83%	66.86%
30%	70%	APCIMS Balanced Index	9.29%	61.31%

**Question 10:** Assuming the return on the portfolio you have identified is broadly to be the basis on which the discount rate is to be calculated, what range of data should be included in the calculation? Please consider whether the data should be historic and whether any averages should be simple or weighted.

The report from Mr Quilter (within the Appendix to the ABI submission to the Consultation) indicates that there are good returns which are likely to be made from prudent and low risk investment in a split of ILGS and equities which are being achieved by claimants. The averages should be weighted to represent the likely split in investment that is set out. Any conservative estimate of returns, net of investment charges, indicate that on a 70/30 (Gilt/Equity) portfolio gross returns of 3.98% can be achieved in years 1 to 5, 4.80% in years 5 to 15 and 6.84% in the longer term.

The long term average return set out therein is a very conservative forecast which has been achieved in recent years despite a very difficult economic climate. As the economic conditions improve, these returns are even more likely to be achieved or exceeded.

Research by one of our members suggests that at the moment, there are opportunities for Claimants to invest in very low risk but high return deposit accounts 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%.

Another example are a large firm of UK wide Solicitors, (Irwin Mitchell LLP) also provide investment management through a wholly owned (separate) company IM Asset Management where they advertise that the current yield of their 'cautious portfolio ' is 4.58%.

<http://www.imassetmanagement.com/institutional-services/discretionary-management/risk-graded-portfolios/Pages/CautiousPortfolio.aspx>

## Cautious Portfolio

Introduction

Asset Allocation

Holdings

Important Info

### Objective

The Cautious Portfolio is a low risk portfolio, which is run on a full discretionary basis. It seeks to produce capital stability whilst producing an income by investing in assets displaying growth in the UK and throughout the world. It is by its nature a low volatility portfolio and has reduced growth prospects due to the limited equity content.

### Income & yield

The portfolio currently generates a yield of 4.58% (as at 31 March 2012). This can then be taken as income on a monthly, quarterly or half yearly basis or reinvested into the portfolio as agreed with the investor.

**Question 11:** Should any other factors, such as allowances for inflation, tax or investment expenses, be taken into account and if so, how? Please give reasons.

The law does not permit the recovery of such charges as a head of claim and as in our answer to Question 7, the Lord Chancellor and the Scottish Ministers should set the rate of return net of any of these factors.

### Discount rate methodology – what approach should be adopted?

**Question 12:** Should the Lord Chancellor and his counterparts in Scotland and Northern Ireland set the discount rate under section 1 of the Damages Act 1996:

- a) by retaining an ILGS based approach but changing some or all of the detailed criteria used (option 1);
- b) by moving away from an ILGS based approach to a mixed portfolio of investments based approach (option 2); or
- c) by reference to some other approach? If so please give details.

Please give reasons for your choice.

The Lord Chancellor and Scottish Ministers should adopt the rate of return on a mixed portfolio as set out above because:

- Whilst the current yield from ILGS may suggest that the discount rate of 2.5% is too high, that view should be adjusted by the overwhelming evidence that the vast majority of claimants in high value cases still choose to settle on a lump sum basis instead of PPOs.
- The presumption has to be that the claimant is receiving proper financial advice (it would be negligent of their legal advisors to do otherwise as suggest by Lord Stewart in our answer to Question 1) suggesting that the claimant can achieve through real investment, a rate of return of more than 2.5% (supported by the evidence contained in our appendices referred to earlier as well as our answer to



Question 10)

- Assumptions based solely on ILGS are wholly unrepresentative because of the current situation of a short term history of volatility. This would entirely ignore the likely medium and long term gains.

As an alternative mechanism of settlement, PPOs are available and the Courts Act 2003 (post *Wells v Wells*) gives the Courts in England and Wales the power to order periodical payments.

The mechanism is also 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.

The appropriate methodology of the review should be to look at a mixed portfolio of investments, to receive evidence about the likely medium and long term economic conditions relating to rates of return and inflation, and to look at the medium term returns likely to be achievable on ILGS as part of that mixed portfolio. In other words, to consider 'real' cautious investment rather than create an artificial model or measures.

## A single rate

**Question 13:** Do you agree that one prescribed discount rate is sufficient?

Yes     No

If not, please specify what classes of cases should be affected by different rates and what the differences should be in the ways that the different rates are to be set. Please give reasons.

A single rate has the advantage of simplicity and certainty and should not be departed from.

*Helmut v Simon* in Guernsey had to consider matters differently when approaching care costs as PPOs are not available in Guernsey – all the jurisdictions being considered as part of this consultation **do** have PPOs available, therefore, are not subject to the same considerations

## Suggested discount rate or rates

**Question 14:** What discount rate or rates do you consider would be appropriate now? Please indicate the basis for your decision.

We consider the rate should remain at 2.5%.

There is no good reason made out for the rate to be reduced.

To carry out a rate reduction would be entirely short term 'knee jerk' thinking and not based on quantifiable evidence regarding returns and economic recovery.

The current difficult economic situation does not necessarily translate into a significant impact on longer term investments and economic recovery as a whole.

## Impact assessment

**Question 15:** Do you agree with the impact assessment at Appendix B?

Yes  No

If not, please explain why.

We do not agree with the Impact Assessment for a number of reasons.

The UK already has the highest level of damages in Europe for severe injury claims according to the Swiss RE study in 2007.

If the Government does decide to change the discount rate, we would submit that it should be considered whether it is affordable by the Government itself (NHS claims, and Ministry of Defence) or by society at large to pay for such increase without full consideration of the likely long term economic consequences.

Indeed, one of our insurance members believes that a 1% reduction on the discount rate would cost the insurance industry as a whole, a figure of £1.5bn on current claims.

This additional cost burden transfers onto Consumers through increased insurance premiums to pay for these increases.

Additionally, it follows that any similar cost to the NHS or other public sector bodies would have to be paid for from the public purse putting an additional cost burden on society as a whole.

**Question 16:** Please provide evidence of the investments typically made by claimants with their lump sums and the expected and actual duration of awards of damages for personal injuries.

We again refer the report from Mr Mark Quilter who is a specialist Investment Advisor/Manager. (within the Appendix to the ABI submission to the Consultation)

The report from Quilter confirms the basket of equity approach to investment by the vast majority of claimants:

Number of Clients managed by Charles Stanley PI & Damages Awards Team			
	Asset Allocation	Acceptable level of Risk	Clients
CO1	100% Cash Investment	Medium - Low	71
CO2	Up to 30% Equity	Medium - Low	74
CO3	Up to 50% Equity	Medium/Balanced	72
CO4	Up to 70% Equity	Medium/Balanced	121

**Question 17:** Please indicate whether you consider that these investments carry the appropriate degree of risk for a personal injury claimant reliant on the money to be produced by the award.

We believe these investments do carry the appropriate degree of risk for a personal injury claimant and the underlying fact that the vast majority of claimant's do seek lump sum settlements on this conventional basis is proof of the fact.

If a claimant is particularly risk averse, PPOs exist as an alternative mechanism of settlement which would be entirely risk free so there are already additional safeguards within the overall compensation system.

**Question 18:** Do you consider that investing in ILGS alone is relatively a less cost-effective way to protect claimants against future cost inflation than investing in a low risk mixed portfolio of investments? Please give evidence to support your conclusion.

As previously indicated in earlier answers, we do consider that sole investment in ILGS is less cost effective than a mixed portfolio of investments.

As we have demonstrated in the Quilter report, (within the Appendix to the ABI submission to the Consultation) fully advised claimants seek a mixed portfolio of investment for maximum investment return whilst maintaining appropriately low level of risk. (as is evidenced by the APCIMS indices on fund performance – see answer to Question 9.)

## Small Firms

**Question 19:** Do you agree that the choice of the method of setting the discount rate will not have any direct effect on small firms?

Yes  No

If not, please give details.

We strongly disagree with this statement.

Any reduction of the discount rate will have a significant effect on insurance premiums for small businesses as the cost of insurance claims will rise and the cost of paying these is therefore passed on to the business themselves through having to pay higher insurance premiums, or indeed in the case of consumers, higher home and motor insurance premiums.

Insurance policies operate with indemnity limits, or in other words, the maximum amount the insurance company will pay out. The average small commercial policy would have an indemnity limit of £2 million for Public Liability and Product Liability risks.

Therefore, if the discount rate were to be reduced, the indemnity limit would be breached on a far larger number of occasions.

When this occurs, the business themselves has to pay out any amount over the indemnity limit and can mean putting them out of business as a direct result.

This clearly has wider economic consequences also.

**Question 20:** Do you agree that the discount rate must apply in cases involving small firms in the same way that it does in other cases?

Yes  No

If not, please give details.

There is no reason good reason to differentiate based on the size of firm and indeed, one fundamental principle of law across all UK jurisdictions is parity of Justice between Claimant and Claimant and Defendant and Defendant – in other words, every Claimant is entitled to a parity in the level of compensation regardless of the means or size of the wrongdoer.

## Equality impact assessment

**Question 21:** Do you agree with the equality impact assessment at Appendix C?

Yes     No

If not, please explain why.

We would state that in our experience, poorer households would be impacted most as they are either unlikely to take out insurance cover or do not have the means to pay damages as they have little or no assets.

Even where they did take Household insurance, the standard indemnity limit of £2 million would apply and any cases over that would result in a gap of funding, again, back to the scenario where the household have no financial means to bridge that gulf.

**Question 22:** Do you agree with the equality screening at Appendix D?

Yes     No

If not, please explain why.

We have no comment to make on this area.

**Question 23:** Please provide evidence of any ways in which the current discount rate affects people with different protected equality characteristics.

We have no comment to make in this regard

**Question 24:** Do you consider that the choice of how the discount rate should be set will affect people with protected equality characteristics? (see paragraph 125)

Yes     No

If so, please give details.

We have no comment to make in this regard

## Other approaches and issues

**Question 25:** Are there any other comments you wish to make on how the discount rate should be set?

If the discount rate is to be re-visited, it should be done so with full knowledge of current investment practice and advice in mind. In other words, claimants simply do not invest in ILGS alone and in fact, invest their damages in a mixed portfolio and realise rates of return higher than the ILGS rate (historical or future) suggests.

PPOs exist as a realistic alternative settlement mechanism for claimants who want minimal risk or additional protection and the framework exists in all jurisdictions covered by this consultation .

The fact that very few claimants seek settlement on this basis is testament to the adequacy of investments programmes when claimants accept conventional lump sum settlements.

## About you

Full name

Alan Rogerson

Job title

Vice Chairman

Capacity in which you are responding to this consultation exercise (select all which apply)

Legal representative:

- claimant/plaintiff/pursuer  
 defendant/defender  
 Insurer  
 Judiciary  
 Financial institution  
 Academic  
 Public sector body  
 Business  
 Equality group  
 Member of public  
 Other [please state] Representative body of Insurers, Local Authorities and Claims Handling Companies who operate in Scotland

Date

23/10/2012

Company name/organisation (if applicable)

Forum of Scottish Claims Managers

Address

139 West Regent Street  
GLASGOW

Postcode

G2 2SG

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](mailto:damagesdiscountrate@justice.gsi.gov.uk)**