



Institute
and Faculty
of Actuaries

Damages (Investment Returns and periodical Payments) (Scotland) Bill

IFoA response to Scottish Parliament Economy,
Jobs and Fair Work Committee
(Business Support Inquiry)

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

**SUBMITTING EVIDENCE TO A SCOTTISH PARLIAMENT COMMITTEE
DATA PROTECTION FORM**

Name:	Institute and Faculty of Actuaries (IFoA)
Date:	7 September 2018
Organisation: (if required)	IFoA
Topic of submission:	Damages (Investment Returns and Periodical Payments) (Scotland) Bill, IFoA Response

I have read and understood the privacy notice about submitting evidence to a Committee.

I am happy for my name, or that of my organisation, to be on the submission, for it to be published on the Scottish Parliament website, mentioned in any Committee report and form part of the public record.

I understand I will be added to the contact list to receive updates from the Committee on this and other pieces of work. I understand I can unsubscribe at any time by contacting the Committee.

Non-standard submissions

Occasionally, the Committee may agree to accept submissions in a non-standard format. Tick the box below if you would like someone from the clerking team to get in touch with you about submitting anonymously or for your submission to be considered but not published. It is for the Committee to take the final decision on whether you can submit in this way.

I would like to request that my submission be processed in a non-standard way.

ECONOMY, JOBS AND FAIR WORK COMMITTEE**BUSINESS SUPPORT INQUIRY****SUBMISSION FROM Institute and Faculty of Actuaries****Damages (Investment Returns and Periodical Payments) (Scotland) Bill***General*

1. What are your views on the Bill overall? Is legislation in this area required? How far do you think the Bill will achieve what it sets out to do?
 1. The Institute and Faculty of Actuaries (IFoA) welcomes this opportunity to provide a written submission to the Scottish Parliament Economy, Jobs and Fair Work Committee's Business Support Inquiry into the Damages (Investment Returns and Periodical Payments)(Scotland) Bill. Members of our Periodical Payment Orders Working Party, General Insurance Standards and Consultations sub-Committee and General Insurance Board have all provided input to our submission. Members of the Working Party, Committee and Board have worked closely on Periodical Payment Orders (PPOs) over the last decade. We have also had actuarial input from those involved in providing advice to claimants and defendants.
 2. The IFoA agrees that legislation is required in the area. We have previously stated that we believe PPOs to be the better solution for claimants. Claimants should be properly compensated, and the proposed Bill does address some of the issues of the current Bill: allowing PPOs, prescribing the discount rate and prescribing a formal review. Courts in England and Wales have long had the power to order PPOs, whereas in Scotland this has been confined to a small number of agreed settlements. The Bill if enacted would remove this inconsistency in the possible forms of compensation.
 3. We do not however believe that the approach best meets the needs of the pursuer. In the event of a lump sum, full compensation would not be achieved as the discount rate will be higher than risk-free, and hence the rate will not be consistent with a matching exercise, which is our preferred approach.

Part 1

2. Part 1 of the Bill aims "*to reform the law on the setting of the personal injury discount rate in order to make provision for a method and process which is clear, certain, fair, regular, transparent and credible*". Is it an aim with which you agree? And to what extent do you believe the reform will achieve all these things – a clear, certain, fair, regular, transparent and credible method and process?
 4. We support the objective of having 'a method and process that is clear, certain, fair, regular, transparent and credible'. However, the results will not necessarily be certain even though the calculation is specified: the calculation is laid out and very dependent on market movements - so situations may arise in volatile markets where the calculation changes sharply, and limited scope is permitted to react within cycles. This means that neither insurers nor claimants will have 'certainty' because of the market volatility. For example, insurers write their business many years before all claims are finally settled, and the changes apply retrospectively.

5. The IFoA has previously commented that the needs of the pursuer should be put at the front of the argument. Therefore the approach, by not considering a risk-free rate as a matching exercise would suggest, is not fair to them. Of particular concern is that an insurer would value the claim for solvency purposes by reference to a risk-free rate; it would seem to be unfair to ask an individual in these circumstances to take more risk than an insurer, despite this being the sole financial risk to the pursuer, and with no diversification, no shareholders to support, nor access to additional funds.
3. In terms of who sets the rate, the Scottish Government proposes to have the rate reviewed by the Government Actuary rather than Scottish ministers (as is the current situation). It believes that this will remove the setting of the rate from the political sphere “where there is the potential for pressure from external interests to attempt to influence the outcome” and “should provide fairness to all parties involved”. What are your views?
 6. We support the principle that the setting of the rate should be free of political pressure. The market valuation-based approach we propose would be free from such political pressures.
4. The Scottish Government has chosen to lay down in detail how the rate should be calculated in legislation. Do you support this proposal over the approach taken in England and Wales of leaving much more to the discretion of the Lord Chancellor and an expert panel?
 7. We also support having a structured approach to calculating the discount rate. The market valuation based approach we propose would be free from political pressures and would also be clear and transparent for all to use. We have commented that if the Lord Chancellor retains the power to set the rate in England and Wales, then an independent panel should be used to advise him/her.
 8. Our understanding of the proposals is that although the assessment of the rate lies with the Government Actuary rather than with Scottish ministers, the ministers would however retain powers to amend by regulation the Notional Investment Portfolio and/or the impact of inflation to be allowed for. This suggests there remains potential for significant political influence on the discount rate in Scotland.
 9. One consequence of having a different discount rate setting methodology in Scotland relative to England and Wales is that the outcome of personal injury cases may then also differ, with different rates applying in different jurisdictions. This situation prevails in some overseas countries, Australia and Canada being examples, but differential rates within the UK may raise a number of issues for claimants, lawyers and insurers. Issues could include the perception of unfair treatment between jurisdictions, or temptation to raise a claim in the jurisdiction most favourable to the party making it.
5. With no statutory requirement for the discount rate to be reviewed regularly, currently there can be a 15 year gap between reviews in Scotland. The Government Actuary will start a review of the rate on the date on which the relevant provisions of the Bill are brought into force. Thereafter they will be required to start a regular review every three years and the Scottish Ministers may decide on an additional, out-of-cycle review, but which would not disrupt three-yearly reviews. Do you have any views?

10. We welcome the proposal to increase the frequency of review from the status quo, and in particular a three year review cycle. We also support the intention of having the option to address market movements in the value of the rate such that it remains appropriate during any three year period. Determining when market conditions fluctuate is in itself subjective, and so having a relatively short default review period of three years seems appropriate. However, we do acknowledge that increased frequency of review comes with greater operational costs, and the benefits of increasing frequency should be balanced with any associated costs.
6. In changing the methodology to move away from a rate based on Index-Linked Government Stock (ILGS), the Bill makes provision “on the basis of portfolios described as cautious and which we believe would meet the needs of an individual in the position of the hypothetical investor who is described in the legislation”. The Scottish Government also states: “The portfolio does reflect responses to the consultation that investing in a mixed portfolio of assets provides flexibility and is the best way of managing risk”. Do you think the Scottish Government is justified in assuming that injured people have access to the necessary expertise to achieve this?
11. In relation to the introduction to the question, we do not agree that the investments should be those of a cautious investor, but should be those of a risk-free investor. An insurer would use this either in transferring the risks to a knowledgeable third party, or for purposes of solvency under Solvency II (prevailing insurance solvency regulation). For younger claimants, a particular issue with the departure from a risk-free approach and the adoption of the suggested notional portfolio is that there are still concerns to be addressed regarding the costs of investment management, the increased taxation burden on higher yielding investments, and importantly, re-investment risk.
12. In relation to the question over access to investment advice, we note that in England and Wales, finding data to prove (or otherwise) that claimants have access to investment advice or expertise, has been difficult.

Part 2

7. Where damages for personal injury are payable, the Scottish courts may make a periodical payments order but only where both parties consent. This differs from England and Wales, where the courts have the power to impose such an order. Part 2 of the Bill will give courts the powers to impose periodical payments orders (PPO) for compensation for future financial loss. Respondents to recent consultations overwhelmingly supported courts in Scotland having the power to impose periodical payment orders, seeing this as a way of reducing uncertainty as well as the risk of over-/under-compensating pursuers. What is your position?
13. The IFoA supports the use of PPOs, and the Bill prescribing the power to judges to impose a PPO.
8. How well used do you think the provisions would be in practice? What impact do you think the requirement on the court to ensure the “continuity of payment under such an order would be reasonably secure” would have?
14. When the *Thompstone v Thameside* case linked inflation to wages, and where the claim originated from a motor policy, the take-up of PPOs was much greater. In more recent years take-

up has fallen, and recent information emerging suggests that following the change in the discount rate in England and Wales, the number of new PPOs has been very low.

15. We would expect these dynamics to be reflected in Scotland, particularly with respect to inflation. Of specific consideration is the index to which the claims are linked, which is defined in the draft Bill as being linked to RPI, but which may be changed by a court. A court award using a wage inflation linked index (such as Annual Survey of Hours and Earnings [ASHE] in the England and Wales) would likely follow at some stage, and then the majority of PPO claims would likely settle on a wage-referenced basis.
9. The proposals in the Bill would allow the courts to revisit a compensation award where there has been a change of circumstances (although only where this has been identified in advance). This would represent a change to the current law. Do you have any comments?

16. This approach would at first glance appear to be consistent with the proposal to provide a fair settlement, and is also consistent with the approach in England and Wales. However, we note that there are jurisdictions where greater flexibility is allowed as conditions not prescribed at settlement date are also allowed. This would appear to give improved accuracy of compensating the pursuer than requiring the condition to be specified at the outset.

Overall

10. The Bill overall is intended to support the Scottish Government's national outcome that: "We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others". Do you have any comment?

We do not have any comments to raise in relation to this question.

11. In previous consultations in this area, views have tended to be polarised between pursuer and defender interests. Does the Bill, in your view, manage to balance these interests?

17. We stated in a previous response that the Bill should focus on the needs of the pursuer as their needs are greatest. The court should seek to compensate the pursuer, as appropriate, even if that causes the defender to suffer potential additional financial loss.

Other comments

12. Are there any other aspects of the Bill you wish to comment on?

18. The Bill provides for an additional -0.5% adjustment for 'further margin involved in relation to the rate of return'. It is not clear to us what this margin relates to, nor how it is valued.

19. There is a comment that there should be no costs to the legislation. A change in the discount rate will introduce costs to insurers and defenders unless it increases.

20. Rounding down of the calculated value will create a biased answer, always favouring the claimant. While we recommend putting the needs of the pursuer first, this should not be done in a biased way.

21. The discount rate proposals will not ensure 100% compensation, even if they aim to achieve 100% compensation on average. Individuals will live either longer or shorter than expected, which will lead to under- or over- compensation as applicable.
22. If the change of discount rate is in the months at the start and end of the year, it would lead to additional costs to insurance companies in re-assessing the value of reserves on their balance sheet.