Committee for Justice

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Damages (Return on Investment) Bill: Association of British Insurers

10 June 2021

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Paul Givan (Chairperson)
Ms Linda Dillon (Deputy Chairperson)
Ms Sinéad Bradley
Ms Jemma Dolan
Miss Rachel Woods

Witnesses:
Mr Alastair Ross Association of British Insurers

The Chairperson (Mr Givan): I welcome Alastair Ross, who is the assistant director of the Association of British Insurers (ABI). This session will be recorded by Hansard and a report published on the Committee's web page. Alastair, I will hand over to you to briefly outline some of the key issues, and then we will move on to questions. Thanks, Alastair.

Mr Alastair Ross (Association of British Insurers): Good morning, Chair. Thank you very much for that introduction. Hopefully you can hear me OK; it looks like you can. I am very grateful to the Committee for the opportunity to come in and give evidence today and to those members of the Committee with whom we previously discussed reform of the discount rate in recent months. As with the previous witnesses, you have our written submission, so I will keep my opening remarks to the point and focus on the three aspects that we feel are the most important here.

The first aspect is that the methodology for calculating the personal injury discount rate in Northern Ireland is flawed, out of date — it is literally from the last century — and needs to be reformed by the Bill as soon as possible. The ABI supports the Bill's principle of 100% compensation. That is overdue, and it must be a priority for the Assembly. The Committee has been very clear that it is a priority for it. We hope that the Assembly will reflect that, too. Northern Ireland must have and must use a fit-for-purpose methodology when it is calculating compensation for the most seriously injured people. As we know, the current methodology is based on case law known as Wells v Wells, and that significantly exceeds the 100% compensation principle. The cost of that is borne by taxpayers, consumers and businesses in Northern Ireland.

The Bill's introduction has already been considerably delayed, and, while it absolutely needs to be thoroughly scrutinised by this Committee and MLAs across the Assembly, there are concerns that the Assembly may run out of time to pass the Bill before the end of the current mandate. In that situation, if that were to happen, as the Committee has already heard, the interim rate of -1·75% could become an indefinite one until the formation of a new Executive, the appointment of a new Justice Minister and a new Bill coming forward. That scenario needs to be avoided at all costs. The priority is to get this Bill onto the statute book.

Secondly, we do not support the Department of Justice's so-called Scottish model, because it does not meet the 100% compensation principle that everyone is committed to and aspires to. The Scottish model means overcompensation, as Stuart Anderson and Kevin Shevlin previously set out eloquently, and that will only be paid for by compensators, which is the taxpayer in claims against the NHS or other public bodies, which you covered in the session at the end of last month, and consumers, because it will generate increased insurance claims costs. The ABI supports 100% compensation via a discount rate that reflects the real-life choices that claimants make when they invest their compensation settlements. It is widely acknowledged that they no longer use index-linked government securities, more commonly known as gilts, because that would actually lose them money. When this was originally introduced, gilts had a positive yield and you would be able to generate a return from gilts, albeit not as great as other assets. That was almost 30 years ago. We are now in a situation, post the financial crisis, where gilts are producing a negative yield, so if you put all your money in gilts, it costs you even more money. You lose money. That just does not make sense, and no rational investor would do that, so we need to move away from that as the basis on which everything else is built.

The further margin adjustment in the Bill, which you have just been speaking about, is designed to reduce the risk of under-compensation, even though there is no evidence that under-compensation happens under the current system. That is a policy choice that has been made by the Department of Justice to increase the level of compensation for plaintiffs and go beyond the 100% compensation principle. As we said in our written submission, we still recommend using the England and Wales model, including ministerial accountability, and we may come on to that in the questions.

Finally, the Bill should be amended to remove the further margin adjustment and to revise the notional investment portfolio. As I said, the further margin adjustment is designed to reduce the risk of under-compensation despite the lack of evidence. I point the Committee towards the written submission from the Prudential Regulation Authority (PRA), which is relevant on a number of levels. The Prudential Regulation Authority told the Committee that the further margin adjustment favours the claimant and can be omitted if the Bill wants to achieve strict balance in terms of the 100% principle. It says:

> *"this is essentially a political decision for the N. Ireland assembly."*

You could probably apply that to the other aspects that you were talking about earlier, but that is a fairly significant point to consider. The effect of the further margin adjustment is to add hundreds of thousands of pounds to the value of claims paid by public bodies, insurers and other compensators. You have seen various examples from the Department of Justice, and we provided some examples in our written submission. They show the effect that a 0·25% change can have on the value of the compensation sum.

It is also worth noting that this has been adopted from the Damages (Investment Returns and Periodical Payments) (Scotland) Act, which was passed by the Scottish Parliament in 2019.As others said, the Scottish legislation's financial memorandum noted:

> *"This is intended to recognise that a seriously harmed pursuer is unlikely to be able to meet their needs if they are under compensated. The corollary is that there will inevitably be a probability of over compensation but it will be less than if the rate were set by reference to ILGs"* —

gilts.

Paragraph 12 of the schedule to the Bill adopts a notional investment portfolio from the Scottish legislation, and that is to be used to calculate the anticipated returns on those investments in order to set the discount rate. That notional investment portfolio is overcautious, which, I think, Stuart touched on earlier. The effect of that is that it will depress the discount rate a little. It will lead to a lower discount rate, which, again, will exceed the 100% compensation target.

If the Executive and the Assembly make a policy choice that means more than 100% compensation under the legislation, it is really important to understand and accept the consequences of that choice, which will be higher costs for compensators, which we touched on already, public bodies, taxpayers and, ultimately, consumers. I will round that off by saying that we fundamentally disagree with and oppose the proposed amendment from the Association of Personal Injury Lawyers (APIL) to increase the adjustment for tax and investment charges to 1·5%. That was rejected by the Scottish Parliament. Under the current systems, there is a 0·75% adjustment for investment charges and tax in England

and Wales and in Scotland, and we have not seen any evidence that tax and investment charges in Northern Ireland are any different. I will finish there and try to answer your questions as best I can.

The Chairperson (Mr Givan): Thank you, Alastair. I will not go over some of the points that you have already put on the record. I have one question. You pointed out that the notional investment portfolio is overcautious. What would you recommend to fix that?

Mr Ross: I refer back briefly to the written evidence submission, in which we included research carried out by Pannells Financial Planning, to give it its full title. Pannells looked at that in relation to the Scottish legislation. Its view is that the portfolio was overweight in what is known as fixed investments and underweight in equity investments. The change that we are looking for there is to put more weighting into equity investment — not a wholesale change — in order to level up the portfolio and make it more appropriate to deliver the compensation principle of 100% that we are all working towards. The effect of having a portfolio that is underweight in equities, as this one currently is, is that the person who is relying on it is not hedging their inflation risks efficiently. Equity investments are an effective way to do that. We therefore submit that, if the Department were to increase the size of the portfolio of equities in the overall portfolio, it would be better able to manage that risk.

The notional portfolio is also tied into the point about 43 years versus 30 years, which you covered off earlier, but, to add to that, the longer the investment period of the portfolio, the greater capacity there is for the portfolio to achieve the return that it is trying to deliver for a person to smooth out the effects of short-term changes in the markets, if markets in any asset class go up and down. We encourage the Committee to ask the Department to demonstrate the evidence for its policy decisions here, as Stuart set out quite effectively earlier.

The Chairperson (Mr Givan): OK. Thank you.

Ms Dillon: Thank you, Alastair, for your presentation. I appreciate it. I want to pick up on your point that the cost will be borne by taxpayers, public services and businesses, and I agree with you. However, I notice that you did not say "by the insurers". I am just making the point that insurers will protect themselves at all costs and that the cost will be passed on to the rest of us. They are a business at the end of the day, and I get that, but that point is worth making. That does not belittle what you said in any of your points, many of which, to be fair, I do not disagree with.

You raised the Scottish model, and you have been very upfront about that from the beginning. We had informal meetings with you, and you highlighted at that time that the England/Wales model would be better than the Scottish model. The only thing that I would say is that, if we go back to the beginning with the Department and say that we want the England/Wales model, we will come up against the problem that you have already highlighted, that we end up with the 1·75 as an indefinite, which would be a disaster, for you, public services and everyone right across the board, to be fair.

I am probably being cautious, but I am not against changes to the Bill. If there are changes that would be positive and work for everybody, and if we could make sure that there are better outcomes for everybody, including those who are injured, we should look to that. If you have been watching, you will probably have noted that Sinéad Bradley was one of the people who picked up on that first. I certainly agree with her that we may want to consider periodic payment orders (PPOs), in at least some cases. As Sinéad has outlined, that is as much as for safeguarding as anything, because you have the potential for seriously injured people to invest in extremely high-risk portfolios.

As regards the periodic payment orders, I assume that your view is that they are a positive thing. However, I do not want to assume that, so I will allow you to answer that one.

Mr Ross: Thank you very much. There is quite a lot in there, so I will be as concise as I can. There are few things in what you have said that I want to address.

I absolutely recognise the risk of going right back to square one, and the England and Wales model. Bearing in mind what I said at the start, about the importance of getting this legislation passed, we are where we are with the Scottish model. You have summarised the position and the situation that we are in better than I could, so I do not disagree with you on that at all.

I will come to PPOs in a moment, and perhaps expand upon the insurance perspective on those and how they operate.

I absolutely appreciate what you say about insurers' own interests, and I have seen and noted what you have said in previous sessions. Insurance is a commercial contract. If you break it down to its very basic level, a customer pays a premium to the insurer and, in return, the insurer takes their financial risk onto their own balance sheet. If there is a claim, they pay out. If an insurer takes in more money via premiums than it pays out on claims over the course of a year, it makes a profit. That is how insurance works, and I do not think that there is anything controversial in that. However, if an insurer takes in money via premiums and does not have to pay out as much in claims and makes a profit, but then there is a single case, known in the industry as a large loss case — the kind of case that would result in, usually, a seven-figure compensation settlement, and one which would involve the personal injury discount rate — it can cost several million pounds, as we set out in our submission. That would be a substantial loss on that particular policy, and the way that insurers address that is that they take on these liability risks, hoping to make a profit, but they need to price and prepare on the basis that each one of those policies could result in paying out in a multimillion-pound compensation settlement. Therefore, they need to price accordingly to make those decisions.

I know that you discussed previously whether insurers should absorb more of the cost, but the reality is that, when we are talking about this, we are talking about two major areas of liability insurance. The first is motor insurance, which individuals and businesses that operate fleets pay, and that is a pretty competitive market across the UK. As it is a competitive one, the profit margins are very small. The profits made on selling thousands of policies, where no major claims are incurred, could then be offset by a single multimillion-pound compensation settlement.

To put a bit of perspective on that, the ABI collects data on premiums and claims. We hold it at a UK level, so, unfortunately, we do not have a Northern Ireland breakdown available at the moment. However, over the past 10 years, the UK motor insurance market has made a loss. It has paid out more in claims than it has taken in through premiums in six of those 10 years. The combined underwriting losses for those six years were £3·3 billion, and the combined profits, in the four years when it made a profit, was £837 million. That is an overall loss of £2·4 billion in the UK motor insurance market over the past decade.

The employers' liability insurance market is not quite on the same scale, but, again, it has recorded an underwriting loss in seven of the past 10 years. In those seven years, it has paid out more in claims than it has taken in in premiums. Total losses were just over £1 billion, and total profits £459 million. That represents an overall loss of £627 million over that 10-year period, taking those individual lines of insurance on their own. In relation to using the profits from other lines of insurance to contribute to insurance funds' overall financial performance as represented in their end-of-year results, it is not fair to — you cannot — rely on profits from other areas to offset the costs or losses of liability claims. Insurers therefore face significant cost exposures at the moment.

The decision to change the discount rate from +2·5% to -1·75% is having an immediate effect on the costs of insurance claims. That is because when the law said that the discount rate was 2·5%, insurers will have written that level of cover. Now the law says that the discount rate is -1·75%, and that puts significant inflationary pressure on the cost of meeting a claim and paying out. The potential scale of serious-injury compensation could more than treble in some situations. That puts pressure on the insurers' costs, and insurers will price that accordingly. As I said, hopefully, in the short term, insurers in Northern Ireland have written cover on the basis of 2·5% and are now paying out on the basis of -1·75%. That has a huge impact.

I want to reassure you, because I know that there are concerns. Kevin Shevlin covered the legal position on PPOs very effectively, and, hopefully, that has reassured you. For further reassurance, under international insurance regulations, insurance companies have to reserve sufficient capital to pay out on every liability that they take on when they write a policy. They have to set aside sufficient funds so that they can pay out as and when that policy is due. The system is not set up so that profits from one area can be used to offset the potential liabilities of a multimillion-pound claim for a case involving the personal injury discount rate. I have gone into quite a lot of detail, but I hope that that is helpful in relation to your point on costs and profits.

Kevin has summarised the position regarding the legal protections for PPOs very effectively. That protection extends under the Courts Act 2003, because insurers are regulated financial services companies. The financial services compensation scheme will continue any PPO payments in the highly unlikely event that an insurer goes into administration or is liquidated. That is an incredibly rare event.

From an insurer's point of view, a PPO is a more complex settlement option. With the option of a lump sum settlement, the sum is agreed, the insurer pays it, and that is it. The two parties go away, the plaintiff has the money, and they do not have to have any other contact with the compensator. The compensator has paid out the money and does not have to make any other reservations on its book. A PPO means an ongoing relationship. As Kevin said, it can be an annual or a more regular payment, and that will last the plaintiff for the rest of their days. The insurer, therefore, has to budget for that ongoing payment going out and reserve sufficient capital to make sure that that happens, so it is more complex from the insurer's point of view.

An important point worth noting with PPOs is that the initiative, for want of a better term, in the whole process of settling a compensation claim for serious injury is with the plaintiff and their solicitors. It is in the gift of the plaintiff and their solicitors to request a PPO and say, "That is the option that we would like". In Northern Ireland, at the moment, the courts cannot impose or enforce that. The equivalent legislation in Scotland provided for that, although it has not been implemented yet. It is really for the plaintiff and their solicitor to say, "We have looked at it. We have looked at the benefits of a PPO and of a lump sum, and we would like to go for the PPO". It is not the insurer's place to say, "We propose a PPO". The reality is that, if a plaintiff comes forward and says, "We would like a PPO", I cannot think of any circumstance under which an insurer could realistically decline that request. The issue is that very few plaintiffs' solicitors appear to recommend that to their clients. I defer to your subsequent witnesses on why plaintiffs or their solicitors tend to lean towards lump sums. It would be good to get a better understanding of that.

The other point relating to that is the option of interim payments. Those cases take a long time to settle. It is years rather than months, unfortunately, because of the complexities involved. Throughout that period, there is the opportunity, if the plaintiff and their solicitor makes a representation to the insurer, where they can get an interim payment, a drawdown of part of the compensation, in advance. So, if the nature of their injury meant that they needed to move residence, for example if they were in a high-rise flat that was no longer accessible and they needed to move into ground-floor premises, things like that can be agreed so that funds can be released in advance on an interim basis. Again, that does not seem to happen an awful lot. Insurers, again, would respond positively if these approaches were made, but, as I said, for want of a better term, the initiative rests with the plaintiff and their solicitors on that. Insurers will collaborate and cooperate wherever they can on that. Hopefully, that helps to set out the position on PPOs and the scope for them in Northern Ireland.

Ms Dillon: It does, Alastair, and I think that it probably adds another layer to my assumption. I was right not to assume because you have outlined that there are some complexities around PPOs for the insurance company where they would have to put in the administration costs. That is a fair enough point. It is not one that I had considered, to be fair. I appreciate that. Chair, those are all the questions I have for Alastair. Thank you, Alastair.

Ms Dolan: Thanks, Alastair. You mentioned in your statement that the notional portfolio is overcautious, and you also said that there is a lack of evidence on how claimants invest their settlements. If there is a lack of evidence on how claimants invest their settlements, what backs up the assertion that the notional portfolio is overcautious?

Mr Ross: To be honest, Jemma, there are two different things. The notional portfolio is how you think somebody would invest over a period of time, regardless of whether they have a serious injury or not. So, it is a theoretical construct where they say, "I need to achieve a certain return on an investment over a certain period of time. What are the best ways to do that?". You then set that out.

On the lack of evidence, as I said, it goes back to the point that I made earlier that, when a lump sum settlement is reached, the two parties go their separate ways. So, there is very limited visibility on what happens after that. From the ABI's point of view, we have done our best. We carried out some research, and we shared that with the Committee and with the Department previously. I think that there were about 2,500 settlements to see the average length of time that that money needed to last an injured person. That came out, and, from memory, I think that it was about 46 years. We agree with the Department, and I am very pleased to see that it has taken that on board and adapted the Scottish model to use this 43-year calculation, as opposed to the 30-year calculation, because the combined effect of this overcautious notional investment portfolio that is very cautious and is, therefore, less likely reach the returns that you are looking for and a shorter investment period would really depress, for want of a better term, on the ultimate calculation of a personal injury discount rate. That is where our concerns are in relation to how that is calculated and how that is worked out. I guess that we are

reliant on the plaintiffs' solicitors because they will tend to have more contact with plaintiffs after the case has been settled.

One area in which I absolutely agree with the Association of Personal Injury Lawyers (APIL) is where it says that injured people are not stockbrokers. That is absolutely right, but the reality is that most plaintiffs' solicitors will advise the plaintiffs to get independent legal advice, and, in many cases, they will refer them onto firms. I think that APIL mentioned some firms in its written submission. Those are the types of firms that can provide independent financial advice and work through that. That suggests to me that the plaintiffs' solicitors and, certainly, the advisers will have an ongoing relationship with those people.

It would have been really helpful if that analysis and information could have been sought from them so that they could provide a better picture of what happens to lump sums after they have been handed over. Do people invest just in index-linked government securities? I think almost definitely not now, because of the reasons that I set out earlier. If you did that and put all of your assets and your compensation settlement into gilts, you would be paying money to the UK Government rather than it generating money or an interest return for you. The idea that that is how people invest has gone. It is from a previous time. It was maybe applicable back in the late 1990s, when that was designed and Wells v Wells was considered, but it is now significantly out of date, which is why we need reform. We need the Bill to go through to reform the methodology, which is, literally, from the last century. It is fundamentally out of date.

Does that answer the question, or have I made it more confusing?

Ms Dolan: That is a wee bit clearer, Alastair. Thank you.

Ms S Bradley: Thanks, Alastair. This has been very informative so far. A lot has been covered, so I will hone in on one or two particular points. I concur with the view that the notional portfolio is risk-averse. We are very caught up in the framework. Those individuals have, through no fault of their own, had their life chances and opportunities restricted quite heavily. I hope that they are directed to get financial advice and that it would be to take a very cautious approach. That money has to last for a lifetime. I accept that the notional portfolio has to err on the side of caution, perhaps not reflecting the market, but, to my mind, the longer the investment, the more of a return that you will get.

The point about 0·75% talks about engagement with a professional adviser. It takes into account any taxation and all of the costs that might be associated with it. I take your point about the move to the 0·5%. My reading — I could be wrong, but I will put it to you — of that 0·5% is that, if there is a release valve or an inflation valve in the legislation, that is it. It is stated that that 0·5% can be modified by regulation through the Department of Justice. It could actually go to zero or a positive number. Is there a danger in that not being there? It may have an effect, even to your betterment, if you want to argue in that respect. I think that, if the argument is made by either party that the rate should be different, the judge has it within their capacity not to accept the rate. I am conscious that it is very difficult to predict every circumstance and every time. There is value in having that piece there. I would be very reluctant to just throw it out without understanding its full effect. Do you have any further thoughts on that?

Mr Ross: That is a really good question, Sinéad. Thanks very much. It is an important point. It is also a complex one. It is quite a technical and niche area of insurance, let alone insurance law. It is an interesting concept. I had not really considered the 0·5% as a release valve. Your point about the scope to modify it is an interesting one. The question would be what appetite there would be and how easy it would be to do that.

Scotland has incorporated that 0·5% into its legislation. That passed in 2019, and there has been no discussion about it or about revisiting it. Obviously, attention has been elsewhere due to the pandemic, but that is not being considered or discussed in Scotland at the moment. As I understand it, from the way in which the Bill has been drafted and from discussions with the Department of Justice, the intention is that it is a fixed adjustment so that the Government Actuary's Department (GAD) runs the calculation that has been prescribed to it by the Department through the legislation and produces a recommended discount rate. A further margin will then be deducted regardless of what the inflation situation is or whatever else is going on. I go back to what the Prudential Regulation Authority said: it recognises that that favours the claimants. It can be omitted if you want to achieve strict balance in the legislation, but it is, essentially, a political decision rather than one that is required in order to reach the 100% compensation principle. As the PRA said, that is a really important point, and I would defer to it on that.

The other question in my mind is about the suggestion that the further margin is required because some people have a very low, or almost zero, investment risk appetite. They do not want to risk losing any of their compensation settlement at all. That is a perfectly valid view, and I understand it entirely. The answer to that is probably to go into a PPO, a periodical payments order, which absolutely guarantees that you will have a regular payment coming in for the rest of your lifetime. There are opportunities to review that, if circumstances change substantially: if your condition were to get worse, for example, or the macroeconomic situation were to change significantly.

If the PPO is available as an option, the question is this: why do you need that further margin adjustment? If the further margin adjustment is there just to guard against the risk of under-compensation and deliberately introduce overcompensation, and it is designed to act as a device for those people who have very low or zero investment risk appetite, why would those people not take the PPO if it were available?

Ms S Bradley: Thanks, Alastair. I appreciate that that is only my interpretation. It could be wrong. We can explore the Department's rationale or whether it is cut and paste without rationale. We need to find that out and explore that with the Department. I am not minded to do anything that would take options away from the recipient. I do not think that it is reasonable to just say, "Well, then, take the PPO". The options should be available, because there may be personal or family circumstances in which the PPO does not fit. For that reason, we could do with exploring it a bit more.

There is one other thing, Alastair, while we have you. Is the review period of five years in the legislation an issue? Do you think that it is reasonable?

Mr Ross: I stand to be corrected, but I think that the proposition is that the initial rate be reviewed in July 2024, which is a little over three years away. I think that the intention is that it would fall into the same review cycle as the one for England and Wales and the one for Scotland, so that GAD is doing three different review exercises but doing that work at the one time, because there is an element of overlap. After that, in Northern Ireland, it would move to five years.

That is a really important point, and you are absolutely right to raise it. The evidence that you took from the Medical Protection Society last week was very much in line with how we see it. If the review period is too short, there is always the risk — I think that three years had been suggested as a potential period; it is not unusual for those cases to run beyond three years — that there may be a calculation in the latter stages of a settlement by one side or the other that says, "If we hang on for another six, 12 or 18 months, the rate will be reviewed and it might be more advantageous to us". That could apply on either side.

In that case, there is this very simple question to ask: is that in the best interests of the plaintiff? A person has suffered serious injuries that have literally changed their life. Is it justifiable to hold off for a further six, 12 or 18 months, just to see if the rate changes, and then try to reach a settlement? There is a real risk that you could have that kind of behaviour if the review period were any shorter than five years.

Similarly, a review period of longer than five years would not be practical. The discount rate that was effective in Northern Ireland until the start of this month was 2·5%. That was set in 2001 and lasted until 2021. That is far too long. Some of the problems that we are now facing have been allowed to develop because nobody has gone back and looked at that and reviewed it. We are where we are. Five years is probably the most practical, sensible and fairest review period for both sides.

Ms S Bradley: OK. In one of the other presentations, I was pleasantly surprised to find out how many settlements happen outside court. I was mindful of there perhaps being bottlenecks every five years, and interim payments maybe becoming a bigger focus in those periods when people get the initial money that they need. That is a reasonable response. Thank you, Alastair. I appreciate that.

The Chairperson (Mr Givan): Thank you, Alastair, for your time.