This document relates to the Damages (Investment Returns and Periodical Payments)](Scotland) Bill (SP Bill 35) as introduced in the Scottish Parliament on 14 June 2018

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

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Policy Memorandum

Introduction

1. As required under Rule 9.3.3 of the Parliament's Standing Orders, this Policy Memorandum is published to accompany the Damages (Investment Returns and Periodical Payments) (Scotland) Bill introduced in the Scottish Parliament on 14 June 2018.

2. The following other accompanying documents are published separately:

- Explanatory Notes (SP Bill 35–EN);
- a Financial Memorandum (SP Bill 35–FM);
- statements on legislative competence by the Presiding Officer and the Scottish Government (SP 35–LC).

3. This Policy Memorandum has been prepared by the Scottish Government to set out the Government's policy behind the Bill. It does not form part of the Bill and has not been endorsed by the Parliament.

Policy Objectives of the Bill

4. The overall policy of Part 1 of the Bill in reforming the law on the setting of the personal injury discount rate is to make provision for a method and process which is clear, certain, fair, regular, transparent and credible. Part 1 of the Bill will:

- put in place a new statutory regime for calculating the discount rate which should be applied to future pecuniary losses for personal injury cases;
- establish a timeframe for the review of the discount rate; and
- provide that the task of reviewing and assessing the rate will fall to the Government Actuary.

5. Part 2 of the Bill will give courts the powers to impose periodical payments orders (PPO) for future pecuniary loss.

6. The Bill was announced as part of the Programme for Government on 5 September 2017. It supports the national outcome that:

> "We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others."

The Bill: Part 1 - Returns on investment of damages

Background

7. An award of damages is designed to compensate a wrongly injured person for the loss and harm caused by the injury – no more and no less. Where damages for personal injury are awarded for future pecuniary loss in the form of a lump sum, that award is adjusted to reflect the fact that the injured person is able to invest the money before the loss or expense for which it awarded has actually occurred. That investment will generate a return and the factor by which the award is adjusted is determined by the personal injury discount rate (PIDR) which represents the rate of return which can be expected from an appropriate investment.

8. Not all personal injury cases will involve the application of a discount rate and indeed the majority probably do not. The discount rate is only relevant in cases where there are future losses which will require to be met –such as future salary losses and/or future care costs. Such cases tend to involve more serious injuries where there is little prospect of the pursuer recovering to the extent of returning fully to commensurate work and/or be able to look after themselves entirely independently.

9. Rather, it is likely that they will require at least some on-going support for the duration of their anticipated life expectancy or for a lengthy period. Examples of the sorts of cases where the discount rate may apply would

include: some clinical negligence cases, some serious road traffic accidents, or some industrial accidents, where in all cases they result in catastrophic injuries. These are life-changing injuries which are so severe that they require significant medical treatment and which usually result in a long-term or permanent effect on the injured person's life.

10. Section 1 of the Damages Act 1996, as amended, provides that in determining the return to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury a court shall, subject to and in accordance with relevant rules of court, take into account such rate of return (if any) as may from time to time be prescribed by an order made by the Scottish Ministers. This is the PIDR. The rate is set separately for Scotland by the Scottish Ministers, for England and Wales by the Lord Chancellor and for Northern Ireland by the (Department of Justice) Northern Ireland Administration.

11. The discount rate was first set by the Scottish Ministers at 2.5% in the Damages (Personal Injury) (Scotland) Order 2002, SSI 2002/46. The same rate had been prescribed by separate subordinate legislation for the rest of the UK in 2001. Following a review of the rate, the Scottish Ministers[1] and the Lord Chancellor[2] separately changed the rate from 2.5% to minus 0.75% in March 2017. On each occasion, the rate was set by reference to a three-year average of real gross redemption yields on Index-Linked Government Stock (ILGS) in line with the 1998 House of Lords decision in *Wells v Wells*[3]*.* ILGS interest and capital payments are adjusted to take inflation into account.

12. In the case of *Wells v Wells* the House of Lords decided that pursuers in personal injury cases were not in the same position as ordinary investors. The lump sum awarded to meet future pecuniary loss should: fully compensate the pursuer (neither more nor less); be sufficient to meet all the expected losses in full as they are expected to fall due without shortfall; be exhausted (along with the income assumed to be earned on the capital sum during the period of the award) at the end of the period for which the award is made; and be set on the basis that personal injury

[1] http://www.legislation.gov.uk/ssi/2017/96/made
[2] http://www.legislation.gov.uk/uksi/2017/206/contents/made
[3] 1999 1 AC 345; in which the Appellate Committee of the House of Lords considered appeals from the Court of Appeal in England and Wales.

claimants are to be treated as very risk averse. Such pursuers, in the view of the House of Lords, could not leave the ability to pay for essential services to the risk of fluctuations of the investment market. The House of Lords was of the view that the discount rate should be the rate of interest expected where the investment is risk free so that when the investor needs the capital its value will not have been eroded by inflation. In its view, 100% investment in ILGS was the most suitable proxy.

13. The most recent change of the rate has led to renewed calls for a re-consideration of the way the discount rate is set. Concerns have been raised about the present method, based on the principles established in *Wells v Wells* outlined above. The main criticism is that this approach, setting the rate by reference to returns on ILGS, intrinsically over-compensates many pursuers.

14. The investment landscape around ILGS has changed significantly over the period since *Wells v Wells*.ILGS yields have declined, particularly since the financial crisis of 2008. ILGS are widely available but it is challenging for pursuers to construct a portfolio of ILGS that matches their expected needs. If their award is of a particularly long duration (e.g. a serious injury at birth) there are currently no ILGS with a maturity date beyond 2068. ILGS also have the potential to undercompensate where the costs of any aspect of what the award is meant to cover rise faster than inflation. In any event, investment in only one investment vehicle is generally not advisable. More generally, it is arguably illogical to assume that anyone would invest in such a way so as to generate a negative return.

Consultation

15. The Scottish Government has consulted on the discount rate jointly with the Ministry of Justice (MoJ) on three occasions. In 2012 the consultation paper *Damages Act 1996: The Discount Rate How should it be set?*[4] sought views on how the discount rate should be set under the constraints of the current law. A second consultation paper, *Damages Act 1996: The Discount Rate - Review of the Legal Framework*[5]in 2013 sought

[4]https://consult.justice.gov.uk/digital-communications/discount-rate/supporting_documents/discountratedamagesact1996consultation.pdf
[5]https://consult.justice.gov.uk/digital-communications/damages-act-1996-the-discount-rate-review-of-the/supporting_documents/damagesact1996discountrateconsultation.pdf

views on whether the legal parameters governing the way in which the discount rate prescribed under section 1 of the Damages Act 1996 is currently calculated should be changed; and whether there was a case for encouraging the use of periodical payments. This second issue was primarily examined in the context of the law of England and Wales and Northern Ireland only. On the first issue, widely diverging views were expressed and overall the responses demonstrated very little consensus on whether the current legal parameters were appropriate. In general, views are polarised between pursuer and defender interests. On the second issue there was only limited support for the greater encouragement of periodical payments in England and Wales for a variety of reasons.

16. In 2015, *A report for the Ministry of Justice*[6] was prepared by Paul Cox, Richard Cropper, Ian Gunn & John Pollock. The function of the report was to assist Ministers in their review of the responses to the consultation paper entitled *Damages Act 1996: The Discount Rate - How should it be set?*, to help with Ministers' decision-making about at what level the discount rate (or rates) should be set, how the rate (or rates) should be calculated and what circumstances should trigger future reviews.

17. The report looked at the types of investment suitable for a personal injury claimant of the type envisaged by the law relating to the setting of the discount rate who is in receipt of an award of damages for future loss caused by personal injury. It also considered the risks attached to investments.

18. Ultimately, the panel did not agree on all of the issues. It concluded by saying: "What is clear to the panel is that the current discount rate of 2.5% is inconsistent with current market conditions, with a risk free approach suggesting a discount rate of -1% and a 'very low risk' mixed portfolio approach suggesting a discount rate of 0% to 0.75%."

19. In March 2017, the Scottish Government again consulted jointly with the Ministry of Justice (MoJ) on how the discount rate should be set in future[7]. The main issues covered in the consultation paper were: what

[6] https://consult.justice.gov.uk/digital-communications/discount-rate/results/discount-rate-report.pdf
[7] https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting_documents/discountrateconsultationpaper.pdf

principles should guide how the rate is set; how often should the rate be set; and who should set the discount rate?

20. A total of 135 responses to the 2017 consultation paper were received. Of these, the main group of responses (approximately 25%) was received from the insurance industry. Broadly equal numbers of responses were received from solicitors representing claimants/pursuers, solicitors representing defendants/defenders and barristers. Responses were also received from a range of other bodies, including financial advisers, actuaries, forensic accountants, underwriters, medical defence organisations, other health service bodies, business and trade organisations, bodies representing the legal profession and the judiciary. The MoJ published an analysis of the consultation and the Scottish Government agrees with the section relating to what respondents said.[8]

21. Most respondents believed that the law on how the discount rate is set is currently flawed. Some thought the law itself was not at fault, but rather the way in which it had been applied. Nevertheless a clear majority of respondents said that the law should be changed in some way. On this, some general themes also emerged from the consultation about the need for clarity, transparency, certainty and the avoidance of conflict of interests.

22. The consultation paper suggested a range of principles (set out below) and asked consultees whether, if the law were to be changed, these principles would lead to 100% compensation, neither more nor less. The proposed principles, with which most respondents broadly agreed, were:

- The discount rate should be the rate that in the reasonable opinion of the setter is (a) consistent with the returns expected from the investment strategy implied by the appropriate risk profile of the claimant and (b) satisfies the following:
    - the lump sum payable after the application of the discount rate plus the assumed income expected to be earned should represent the full loss, neither more nor less, caused by the wrongful injury;

[8] https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-web.pdf

    - the losses and costs assessed by the court to flow from the injury should be met on time; and
    - the capital and the income assumed to be earned from the award must be exhausted at the end of the period for which the award is made.
- In addition, that due regard should be given for the following factors:
    - actual returns that claimants are likely to receive on investments; and
    - availability of a Periodical Payment Order (PPO) in respect of some or all of the loss.

23. Following the consultation, the Government Actuary was approached by the MoJ to analyse outcomes for those in receipt of a lump sum award of damages for future financial loss under different illustrative PIDRs which, based on information gathered during the consultation, reflect the way that these awards are invested.[9] The Government Actuary is the head of the Government Actuary's Department which is a non-ministerial department of the United Kingdom Government responsible for providing specialist actuarial analysis and advice to a wide range of other Government departments and public sector clients. Key messages about ILGS from the analysis are that they are not a risk free investment and that no-one would be advised to invest an award solely in ILGS. Current returns on ILGS are even lower than when the rate was set in January 2017. The analysis is commensurate with and supports the views expressed by the Government Actuary in his letter to the Scottish Government of 24 March 2017.[10]

24. The MoJ commissioned a *Briefing Note on the Discount Rate applying to Quantum in Personal Injury Cases: Comparative Perspectives*[11]

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[9] https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/gad-analysis.pdf

[10] http://www.gov.scot/Topics/Justice/law/damages/damagesetc/GAD-to-SG-24-March-2017

[11] https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/biicl-comparative-law-report.pdf

from the British Institute of International and Comparative Law which examined:

> '…the discount rate applying to quantum in personal injury claims from a comparative law perspective focusing on Australia, Canada, France, Germany, Hong Kong, Ireland, Spain and South Africa. These jurisdictions represent common and civil law jurisdictions, a diverse geographical spread as well as a range of approaches and rates. The research highlights the great variety of approaches adopted in adjusting damages awards to take account of investment opportunities. The decision-maker as regards the discount rate is the legislator in some cases, the judiciary in others and a hybrid solution involving both in others. In some jurisdictions, whilst the rate is set through primary or secondary legislation, the court is empowered to vary it in the interests of justice, though this rarely occurs in practice. There is also considerable variety in the methodology for setting the rate, including which institutions are involved in the process and what considerations are taken into account.'

25. The comparative analysis in the *Briefing Note* reveals a number of trends and differences across the jurisdictions both in terms of the level of the discount rate, the process and basis for setting that rate and the methodology and frequency of its review. It is particularly striking that the level of the discount rate across the representative countries is so different. In some jurisdictions, for example in the Australian States, the rate appears to be set by reaching a compromise where fairness to a pursuer is balanced with the impact on insurance premiums. Professor Mark Lunney commented at Annex 2 paragraph 15 'the discount rate in Australia seems to be set by reaching a compromise between a discount that accurately reflects the real rate of return a tort plaintiff might obtain if investing in reasonably safe investments and one that takes into account the fact that too low a rate of return might have adverse consequences on the provision and cost of liability insurance'.

Reform of the setting of the discount rate

26. Part 1 of the Bill will ensure that the law on how the discount rate is set is clear, certain, fair, transparent and credible and the rate will be reviewed regularly at least every three years. The existing principle underpinning the setting of the discount rate has become known as the 100% compensation principle. The Bill does nothing to disturb this

principle. However, the Scottish Government recognises that the assessment of a lump sum award of damages, particularly for future loss, can never be an exact science and that there will inevitably be levels of under- and over-compensation because of a range of factors.

27. It is right and fair that pursuers should be fully compensated for their losses. It would be naïve however to think that calculating full compensation is readily achievable or straightforward. The parties in a personal injury action will make every effort to arrive at the ‘correct’ figure, but the reality is that there are a number of factors which may alter the final level of damages agreed between them. The most significant factor is that of life expectancy i.e. how long a pursuer is expected to survive. Assessing life expectancy can be difficult and uncertain; there can be disagreements between medical experts on this point. Parties will have different views on this and the outcome is often arrived at on the basis of compromise. It is most unlikely that a pursuer will live for exactly the assumed period.

28. Similarly the different heads of claim will be subject to negotiation and the final award of damages will reflect those negotiations. In assessing the discount rate to be applied to the award, it is also difficult to predict inflation and investment returns with certainty.

29. In some cases, the pursuer may be partially responsible for their injury and, in these circumstances; the courts will assess the extent to which that is the case and determine the percentage of contributory negligence applicable. If, for example, the court deems the pursuer to be 50% responsible their award will in effect be 50% less than they require. Where a pursuer contributes to their injury they will from the outset have insufficient funds to meet their future needs.

30. The system is therefore inevitably imperfect but, without the benefit of foresight, it can never be anything other than an approach intended to provide the best possible assessment for the broadest range of cases. The Scottish Government remains of the view that the principle of full compensation should be maintained but the realities of trying to achieve it need to be recognised.

Rate assessor

31. Currently, under section 1 of the Damages Act 1996, the Scottish Ministers set the rate of return to which courts must have regard when determining the return to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury. The rate is prescribed in an order made by the Scottish Ministers. The order is a Scottish Statutory Instrument subject to the negative procedure. Before making such an order the Scottish Ministers are required to consult the Government Actuary. Courts may apply a different rate if any of the parties can show that a different rate would be more appropriate in the case.

Consultation

32. The 2017 consultation asked if the rate should be set by (a) a panel of independent experts and, if so, consultees were asked to indicate how the panel should be made up, (b) a panel of independent experts subject to agreement of another person, (c) the Lord Chancellor and her counterparts in Scotland or another nominated person following advice from an independent expert panel (d) the Lord Chancellor and her counterparts in Scotland as at present or (e) someone else. Responses to this question were divided as follows:

Option	Description	Number in favour
A	A panel of independent experts	36
B	A panel of independent experts subject to agreement of another person	17
C	The Lord Chancellor and her counterparts in Scotland or another nominated person following advice from an independent expert panel	48
D	The Lord Chancellor and her counterparts in Scotland as at present	9

E	Someone else	12

33. The two options with most support were thus Option C (the Lord Chancellor and counterparts in Scotland or another nominated person following advice from an independent expert panel) and Option A (a panel of independent experts). It is not clear from the responses whether in terms of Option C, all respondents were in favour of Ministers as opposed to ‘another nominated person’. Overall though there was more support for the options which did not involve Ministers.

34. Arguments in favour of Option A focused around the need for independence and to avoid possible conflicts of interest which might arise in relation to the setting of the rate within Government. Arguments for Option C focused around the need for the rate setter to be publicly and politically accountable.

35. Suggestions about the membership of the expert panel included the Government Actuary, accountants, senior judiciary, actuaries, wealth managers, independent financial advisers, economists, the Bank of England and academics. A few responses also suggested including claimant and defendant lawyers and NHS providers, but a larger number emphasised the need for the panel to be independent of any interest groups supporting either claimants/pursuers or defendants/defenders. A number suggested that the panel should have an obligation to consult before reaching a decision.

36. Of those proposing Option E, a number suggested that the rate should be set by the Government Actuary (two suggesting this person as the chair of a small panel), one suggested the Bank of England, one the Ogden Working Party (an inter-disciplinary working group of actuaries, lawyers, accountants and insurers responsible for compiling the Ogden Tables which are used by the court when calculating damages for future loss in personal injury and fatal accident cases in the UK) and two favoured the use of a set formula.

37. Retention of the power of the court to apply a different rate was well supported in the consultation. Support was generally qualified to the extent that respondents believed it should be used only in exceptional

circumstances and the most frequent example provided of such circumstances was where the pursuer would live abroad where different social and economic factors might prevail. Some respondents and the MoJ in their analysis document are of the view that section 1(2) of the Damages Act 1996 already provides this necessary qualification i.e. exceptional circumstances.

Scottish Government approach in the Bill

38. Whilst recognising the support for the rate to be set by the Lord Chancellor and counterparts in Scotland or another nominated person following advice from an independent expert panel, the Scottish Government proposes to have the rate reviewed by the Government Actuary and, in the event of a vacancy, by the Deputy Government Actuary. The Scottish Ministers will also have the power to appoint a replacement rate assessor provided that individual agrees because whilst it is expected that the Government Actuary will undertake this role for the foreseeable future it is possible, for example, that the office may at some point be materially changed or even abolished and so it is no longer appropriate or possible for the Government Actuary to undertake this role. The court will continue to have the power to apply a different rate if appropriate in the case.

39. The policy decision to place the duty to review the discount rate on the Government Actuary is consistent with, and integral to, the overall policy aim of reforming the law so as to make provision for a method and process for setting the discount rate which is clear, certain, fair, regular, transparent and credible.

40. The policy approach has been to regard the determining of the rate as an actuarial exercise in which there should be no need to exercise political judgement. The proposal is, therefore, to shift the mechanics of determining the rate to a suitably qualified and credible professional. The Government Actuary was selected because of their particular expertise and standing.

41. The legislation will provide, in an accountable way, the framework in which the rate should be set and thereafter the mechanics of determining the rate will sit with an appropriate professional. The Scottish Government thinks this strikes an appropriate balance.

42. This will remove the exercise of determining the rate from the political arena where there is the potential for pressure from external interests to attempt to influence the outcome. The review of the Discount Rate will be firmly focussed on ensuring those who have suffered loss and awarded damages for future pecuniary loss receive the full compensation, neither more nor less. This should provide fairness to all parties involved. The Government Actuary will publish their reasoning in pursuance of professional standards along with a rate ensuring the transparency of the process.

Alternative approaches

43. All of the other options outlined at paragraph 32 above were considered. The Scottish Government considered whether the role should be undertaken by a panel as opposed to an individual. On the basis that the Government Actuary will be able to seek views from a wide range of experts and will have the resources of their Department available to them, the Scottish Government is of the view that the appointment of the Government Actuary is the best match, is proportionate to the task and represents value for money.

44. The Scottish Government also considered whether there were other suitably qualified individuals who could undertake this role. The Scottish Government concluded that it was unlikely that they would necessarily have the standing of the Government Actuary.

Frequency of review

45. Currently, there is no statutory requirement for the discount rate to be reviewed regularly. This allowed a 15 year gap between reviews in Scotland. The consequential change in the rate was significant and doubtless had an adverse effect on defenders. Equally, it could be argued that pursuers were for too long subject to a higher rate of return than necessary. Lack of regular review is potentially detrimental to either party.

Consultation

46. In consultation, most consultees agreed that the rate should be reviewed on occasions specified in legislation. The main arguments in favour from both pursuer and defender perspectives related to the greater certainty that this would bring and the need to avoid another lengthy period

without the rate being reset. It was pointed out that regular reviews would not necessarily lead to a change to the rate on every occasion.

47. The main arguments against were that awareness of a review being imminent could affect litigation behaviour by either pursuers or defenders depending on whether it was anticipated that the rate would go up or down, and that this might lead to delays in settlements when a review was approaching.

48. The consultation paper sought views on whether the rate change should be at fixed or minimum periods of time. Of those that supported fixed dates, the breakdown between the range of periods suggested in the consultation paper was as follows: One year – 28; two years – 4; three years (including between one and three) – 17; five years (including between three and five) – 22; 10 years – two. Two supported less than one year – (quarterly or biannually).

49. The main arguments used in supporting a particular fixed period revolved around the need for certainty and predictability; the need to avoid dramatic shifts in the rate; and the need to minimise scope for adverse litigation behaviour and delays in settlement. Few responses distinguished between whether the period should be a fixed one or a minimum one.

50. A number of responses, primarily from insurers, took the view that in the event of a single rate being adopted, this should only be triggered by shifts in investment returns and not at fixed dates. Again, some taking this position referred to the likelihood of fixed dates fuelling unhelpful litigation behaviour and “gaming” of the system. They believe that the settlement process could stagnate as one or other party delays waiting for a better rate and that this would be highly undesirable. Some respondents also referred to the potential for log jams in the court system.

51. The bulk of the responses supporting this position suggested that if a split rate based on duration were adopted, the short term rate should be reviewed annually, but the long term rate should only be reviewed at much longer intervals. A number of these responses proposed five years for this.

52. This view was also shared by some of those in favour of a fixed review period. But whilst such a downside of fixed review periods was

recognised by some, the benefits of having a regular review and the certainty and transparency that would bring seemed to outweigh the ‘gaming’ concern.

53. In offering an opinion on what the regularity of the review timing should be, there was a majority who favoured annually. This was mainly on the basis that this approach would either avoid or minimise the prospect of gamesmanship. Other advantages of an annual review included certainty and continuity and it being far less likely that any triggers would need to be routinely used to adjust the rate outwith the fixed review period. An annual review would also sit better with a methodology which looked at current investment yields.

54. Those who were in favour of a review period of three or five years considered that these periods were a suitable compromise between certainty for litigants and ensuring that the rate keeps track of returns.

55. The small number who supported a review period of 10 years (or longer) did so in the interests of certainty. There is a theoretical attraction in a longer period as it smooths out returns and is more reflective of the long-term investment needs of pursuers. But in a volatile economy where returns have been in a steady decline, this approach may not be helpful.

Scottish Government approach in the Bill

56. On balance and taking the views of respondents into consideration, whilst an annual review period found most favour with respondents, the Scottish Government has decided that a review should be carried out within three years of the previous review with the possibility of a review being instigated earlier if circumstances point to the need. This will provide a significant degree of certainty tempered with a proportionate degree of flexibility. Given that the review is expected to take up to 90 days, an annual review would be likely to prove unsustainable. The Scottish Ministers will, however, be able to call for a review at any point within the three-year period should circumstances dictate.

57. The Government Actuary will be required to start a review of the rate on the date on which the relevant provisions of the Bill are brought into force. Thereafter the Government Actuary will be required to start a regular review every three years counting from the date on which the previous

regular review was required to start. In addition, the Scottish Ministers may decide to require an additional, out-of-cycle review, but that would not disrupt the cycle of regular, three-yearly reviews. Each review is to determine whether the rate should remain as it is or be changed. Once a review is initiated, the rate setter is expected to complete the review within 90 days of the day the review must start.

Alternative approaches

58. It would be possible to set different periods at which the rate required to be reviewed or to set none at all. It would also be possible to provide for triggers as a result of which the rate should be reviewed.

59. Bearing in mind the overall policy aims of the reforms and the need for certainty and transparency, not providing a mechanism for regular review would run counter to that policy and have little support from respondents.

60. A shorter frequency of reviews is likely to prove unsustainable and would also run counter to the aim of providing certainty.

61. Less frequent reviews of say 10 or more years would not be an improvement on the current position and any changes generated are more likely to be of a larger scale. This could be moderated by having the facility to initiate a review within the 10-year cycle due, for example, to the prevailing economic conditions. This still leaves that initiation as a judgement call and does not fully support the drive for certainty.

How the rate is to be set

62. Currently the rate is set by Scottish Ministers by reference to returns on ILGS. This approach is in line with the House of Lords' view in *Wells v Wells* where the court considered that pursuers were to be deemed to be very risk averse investors and that the discount rate should be based on an investment portfolio which protects against market risk and inflation and at that time 100% investment in ILGS was regarded as the most suitable proxy.

Consultation

63. The 2017 consultation asked if the present law on how the discount rate is set should be changed. Ninety five answered yes, whilst 27 said no.

Those saying they believed there should be a change in the law split into a number of categories: roughly two-thirds of these responses were critical of the current methodology for setting the rate and proposed moving from a rate based on ILGS and the principles set out in *Wells v Wells*. The consultation sought views on how pursuers actually invest and what the assumed investment risk profile of a pursuer should be.

64. The paper asked if it should (a) be very risk averse or “risk free” (*Wells v Wells*); (b) low risk (a mixed portfolio balancing low risk investments); (c) an ordinary prudent investor or (d) other.

65. Most respondents to this question expressed a preference for either (b) (52 respondents) or (a) (41 respondents) as the assumed investment risk profile of a personal injury pursuer. Those supporting option (b) generally made arguments about its flexibility and also that investing in a mixed portfolio of assets is the best way of managing risk. They also referred to the fact they believed this was closest to actual claimant investment behaviour. For those supporting option (a), the vulnerability of personal injury claimants, and their need for full compensation without exposure to risk, were the paramount considerations. Only 17 respondents expressed a preference for Option (c) on the basis that personal injury claimants should not be exempt from the real world of investment risk and should be assumed to have the investment risk profile of an ordinary prudent investor.

Scottish Government approach in the Bill

66. The Scottish Government accepts that it is appropriate to move away from the approach of setting the rate by reference to returns on ILGS because it is clear that this can lead to the chance of significant levels of over-compensation. The Bill will provide a new methodology.

67. The Bill sets out a portfolio with asset classes and percentage holdings which is designed to match the objectives and characteristics of the hypothetical investor also identified in the legislation. In terms of characteristics, the hypothetical investor will have received a lump sum award of damages to replace any loss of future earnings, and to meet future costs, caused by the injury/incapacity they have suffered in order to put them in the position they would have been in but for the injury. The hypothetical investor will be properly advised; the investor’s objective will

be securing that the investment of the damages covers the losses and expenses for which the award was made; there will be withdrawals from the fund to meet those losses and expenses; and those withdrawals will exhaust the fund at the end of the period for which damages were awarded. The hypothetical investor has no other funds or income and relies entirely on the lump sum to meet their injury-related needs and so will take an approach in terms of investment choices which is capable of limiting volatility and uncertainty.

68. In changing the methodology away from a rate based on ILGS, the Scottish Government has made provision for a portfolio constructed on the basis of portfolios described as cautious and which the Scottish Government believes would meet the needs of an individual in the position of the hypothetical investor who is described in the legislation. This is a different approach to that consulted on, which asked about how awards were actually invested. There are difficulties arising from attempting to set a rate on how pursuers have actually been investing. On this, data is not generally available and what is available is historical, some of it based on the 2.5% discount rate which prevailed from 2002 until early 2017 and which is, therefore, arguably not reliable. Given that level of discount rate, pursuers may have been forced into taking more investment risk than they were comfortable with in order to generate the necessary return. Also pursuers' circumstances are varied and the individual's particular circumstances will dictate the level of risk they are prepared to take. 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.

69. The rate assessor is required to calculate the rate of return based on the projected returns on the portfolio over a 30-year period taking account of inflation. (By default this would be based on the retail prices index, but the Scottish Ministers will have power to specify another basis).

70. The Scottish Government accepts that there will be a need to take investment advice and indeed one of the characteristics of the hypothetical investor is that they are properly advised. In light of this an adjustment will have to be made to the rate of return to take account of investment advice, management costs and taxation. The adjustment is set out on the face of the Bill with regulation-making powers for the Scottish Ministers to change the adjustment if required.

71. In the case of a pursuer, investment is likely to be a necessity as opposed to a preference or choice. Damages have the purpose of placing the pursuer back in the position they would have been in save for the personal injury and with the sorts of damages that attract the discount rate this is most likely to be to meet future pecuniary losses and care costs. Damages are not surplus funds which can be speculatively invested. Any losses are likely to be material to a pursuer's ability to meet their needs. For all of these reasons, the Scottish Government considers that a further adjustment is needed to reduce the likelihood of under-compensation. 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. A further adjustment is, therefore, set out in the legislation which will be deducted from the rate of return. The further adjustment is in recognition of the fact that any investment, however carefully advised and invested may fail to meet their needs. The Scottish Ministers will have power to change that adjustment by regulations.

72. In terms of transparency, the Government Actuary will produce a report on the conclusion of each review. The Scottish Ministers will lay the report in the Scottish Parliament as soon as practicable thereafter. The rate will come into effect the following day.

73. Ahead of each rate review, apart from the first, the Scottish Ministers will refresh the portfolio taking into account the current investment advice which would be given to investors with the characteristics of the hypothetical investor. The portfolio can be amended by regulations to maintain its currency.

Alternative approaches

74. It was clear from the consultation that doing nothing to change the methodology for setting the rate was not well supported.

75. An alternative option would be to set the rate by reference to returns on higher risk portfolios. Again it was clear from the consultation that this would not be well supported. The higher the rate of return, the greater the probability of a pursuer being under compensated and therefore the principle of full compensation is less likely to be achieved.

The Bill: Part 2 – periodical payments of damages

Background

76. When there is an award of damages in respect of a personal injury, it is generally paid as a lump sum. Particularly in cases where the losses being compensated relate to longer term future needs, payment by lump sum may carry the risk that it either underestimates or overestimates the actual requirements of the pursuer. In the case of the former, the pursuer may suffer hardship if and when they run out of funds. On the other hand, where a lump sum exceeds the needs of a pursuer, the defender has been unfairly penalised.

77. An alternate available approach is the payment of damages through periodical payments. This spreads the payments over the remainder over the pursuer's life span – usually via an annual payment. This approach has the advantage of mitigating the risks of over- and under- compensation described as they offer the scope to reflect more closely the pursuer's actual needs.

78. Currently, in Scotland, where damages for personal injury are payable, the courts may make a periodical payments order but only where both parties consent. This position differs from that in England and Wales where the courts have the power to impose such an order.

79. There is little experience of parties agreeing periodical payments in Scotland. In 2011 however, in a case[12] where the parties did agree periodical payments as part of a structured settlement, the presiding judge offered some extensive comment as part of his opinion.

> "It is for consideration whether statutory provision ought to be made in Scotland for the payment of damages by periodical payments similar to the provision that has been made in England and Wales and Northern Ireland. Parties were agreed that it would be helpful to have the same provision in Scotland."

80. The opinion also supports the view that in catastrophic injury cases, a lump sum payment is limiting.

[12] D's Parent & Guardian v Greater Glasgow Health Board [2011] CSOH 99

Consultation

81. As part of a wider consultation[13] on damages for personal injury carried out in the first quarter of 2013, the Scottish Government sought views on whether there would be merit in reviewing the existing approach to periodical payments in Scotland.

82. In addition, the Scottish Government asked the same question in 2017 as part of a joint UK wide consultation[14] in relation to how the discount rate is set. There was support for this change in the 2017 consultation. Views have also been sought on a draft of the provisions covering periodical payments.

83. Respondents to both consultations were overwhelmingly in support of courts in Scotland having the necessary power to impose periodical payment orders. They were regarded as a means of reducing both uncertainty and the risk of over- or under-compensating pursuers.

Scottish Government approach in the Bill

84. The existing law doubtless contributes to the fact that periodical payments are rarely used in Scotland. It is recognised that periodical payments can ameliorate some of the risks of either over- or under-compensating a pursuer and that they offer scope to reflect pursuers' actual needs and losses more closely than is possible with lump sums. This supports the principle that awards of damages are, as far as possible, intended to restore a victim to the position they would have been in had the wrongful harm not occurred.

85. The Bill will give the court the power to impose, without the consent of the parties, an order for periodical payments where it is satisfied that the continuity of payments is reasonably secure. Predicting a pursuer's life expectancy with any accuracy is notoriously difficult, which is why a lump sum payment will nearly always either over- or under-compensate a pursuer. PPOs tend to be used where a pursuer has significant or catastrophic injuries where their prospect of employment is non-existent or

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[13] http://www.gov.scot/Publications/2012/12/5980

[14] https://consult.justice.gov.uk/digital-communications/damages-act-1996-the-discount-rate-review-of-the/supporting_documents/damagesact1996discountrateconsultation.pdf

severely diminished. It is, therefore, likely that their sole source of income to meet their daily needs as well as any enhanced care needs is the compensation paid via the PPO. Therefore, continuity of payment cannot be left to chance. The payments to cover the pursuer's future needs will need to continue for either the whole of their life or for the duration of the award, with the result that they should never run out of funding. For that reason, the Bill will provide that the court must be satisfied that the continuity of the payments is reasonably secure before it makes a PPO. The continuity of payments is deemed to be reasonably secure if it is protected by the Financial Services Compensation Scheme (FSCS) or a Ministerial Guarantee given under section 6 or Schedule 1 of the Damages Act 1996 or where the source of the payments is a government body. This special status recognises that, for example, UK-regulated insurers are extremely secure, not simply because of their general strength but also because the payments are guaranteed by the Financial Services Compensation Scheme, and taxpayer-funded bodies are similarly secure. This approach means that the court does not need to spend time satisfying itself of the continuity of payments being reasonably secure where the defender is this type of body because, if such a provider of periodical payments were to become insolvent or cease to exist, the FSCS or the Government would ensure that the ordered or agreed periodical payments would continue to be paid without deduction.

86. The Bill also provides for the variation or suspension of PPOs and similar agreements. A PPO or settlement agreement can be drafted so as to provide for the increase or decrease of future payments in the event of a defined happening or at a defined time. For example, it may provide that payments increase when a pursuer who was a child or infant reaches a specified age and is likely to want to leave the parental home or alternately that payments decrease when the pursuer reaches retirement age. This is a sensible way of dealing with anticipated change in the future.

87. However, not all changes are foreseeable. If it is determined that there is a chance of a change in the pursuer's physical or mental condition at some indefinite point in the future, such that it would result in either a significant over- or under- compensation, then at the outset the court can determine (or the parties can agree) that a party may apply for variation or suspension of the order or agreement. This does not mean that either party can return to the court to say that they want a variation because things simply have not worked out as anticipated, for example because the

pursuer has managed to obtain adequate but cheaper care or because the pursuer has not managed their payments well and money is tending to run out. Rather, it would be a significant change to the pursuer's condition. Similar provisions already exist in England and Wales and Northern Ireland although they have rarely been tested.

88. The Bill (section 5) provides for court approval to be obtained for the assignation of the portion of a payment (under a PPO or similar agreement) relating wholly to expenditure likely to be incurred because of the personal injury concerned. This would cover, for example, future care costs but not future earning loss. The Bill also provides (at section 6) for protection of that same portion of a payment by preventing it from being included in a debtor contribution payment under bankruptcy legislation and provisions on protected trust deeds. It also (again at section 6) excludes the whole of the right to a periodical payment (under a PPO or similar agreement) from forming part of a pursuer's estate in the event of that person being sequestrated, and prevents such a right being included in a protected trust deed arrangement. These are important protections which will ensure that the pursuer's care regime can continue, despite their sequestration or other arrangements on insolvency.

Alternative approaches

89. The Scottish Government is not aware of any viable alternatives to periodical payment orders (PPOs). Therefore the Scottish Government did not consider alternate approaches in respect of this issue other than the status quo. There was, however, no support for the status quo.

Effects on equal opportunities, human rights, island communities, local government, sustainable development etc.

Equal opportunities

90. An Equality Impact Assessment (EQIA) has been carried out and will be published on the Scottish Government website http://www.scotland.gov.uk/Publications/Recent.

91. Equality issues were considered during the policy development process and none of the final proposals were considered to give rise to the possibility of those affected being treated less favourably due to any of the

protected characteristics. The Scottish Government has engaged with stakeholders throughout the policy development process and considered their comments, both positive and negative, to minimise disproportionate impact of the policy on people of protected characteristics (age, disability, sex (including pregnancy and maternity), gender reassignment, sexual orientation, race or religion and belief). The EQIA was conducted based on an evidence review and engagement with analytical colleagues. This enabled policy officials to identify relevant data and establish an informed picture of how this legislative change will impact on equality matters. The EQIA did not identify any differential impacts against the protected characteristics and no changes were required.

92. The proposals in the Bill will apply equally to all of those who have suffered a personal injury caused by another and for whom their injury will result in future pecuniary loss for which they will be fully compensated – no more and no less. The proposals will not result in people being treated less favourably because of any pre-existing protected characteristics. Many of the recipients of awards of damages will have physical or psychological disability, albeit most would not have had such disability before their injury. The aim of the reforms is that they should receive appropriate compensation to meet their needs resulting from their injuries through regular review of the rate under a suitable methodology.

93. The rate will be the rate of return on investments which investors with the characteristics described in the legislation will be expected to receive. There is a single rate which applies equally to all of those pursuer investors, unless a court decides otherwise.

Island communities

94. The provisions of the Bill apply equally to all communities in Scotland and the Scottish Government is satisfied that the Bill has no differential impact upon island or rural communities.

Local government

95. The Scottish Government is satisfied that the Bill has minimal direct impact on local authorities. However, there is likely to be indirect impact on some local authorities who find themselves as defenders in these actions.

This impact is described in the Financial Memorandum and the Business and Regulatory Impact Assessment.[15]

Sustainable development and environmental issues

96. The Scottish Government is satisfied that the Bill has no negative effect on sustainable development. The potential environmental impact of the Bill has been considered. A pre-screening report confirmed that the Bill has no impact on the environment and consequently that a full Strategic Environmental Assessment does not need to be undertaken. It is, therefore, exempt for the purposes of section 7 of the Environmental Assessment (Scotland) Act 2005.

97. The reforms should ensure that pursuers are neither over- nor under-compensated. The award will ensure that the pursuer's future needs are met without the need to rely on state benefits or NHS services in relation to the injury sustained. This will preserve future provision for others. Defenders (insurers and the NHS) will only pay what is required to meet the defenders needs and so policy holders premiums should be protected and NHS provision for others preserved.

Human rights

98. The Scottish Government has considered the effect of the Bill on human rights.

99. Article 1 of Protocol 1 of the European Convention on Human Rights guarantees peaceful enjoyment of possessions. Rights to damages for personal injuries are possessions for these purposes. Part 1 of the Bill alters the way in which the PIDR is calculated and will therefore affect the assessment of damages where future pecuniary loss is involved and will affect the balance of interests between pursuers and defenders. Any change in rate (whether up or down) will take effect on the day after the rate-assessor's report is laid before the Scottish Parliament. The Bill does not make any provision limiting the application of a change of rate only to cases where the right of action arises on or after the date on which the new rate takes effect. Neither does it make any provision limiting a change of rate to cases where the action has been raised (that is, the litigation begun) on or after that date. However, the Bill does not affect the possession itself:

[15] http://sh45inta/Topics/Justice/law/damages/damagesetc

the right remains a right to receive full compensation calculated as accurately as reasonably possible. There is accordingly no interference with a possession. This in in line with the approach taken by the Scottish Ministers in setting the rate in 2002 and 2017 (and also by the Lord Chancellor in 2001 and 2017)[16]: the orders under section 1 of the 1996 Act provided for the new rates to come into effect on a given day without qualification as to the application to rights of action already accrued or to actions already raised.

[16] See S.S.I. 2002/46 and 2017/96 and S.I. 2001/2301 and 2017/206.

This document relates to the Damages (Investment Returns and Periodical Payments)(Scotland) Bill (SP Bill 35) as introduced in the Scottish Parliament on 14 June 2018

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

Policy Memorandum

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