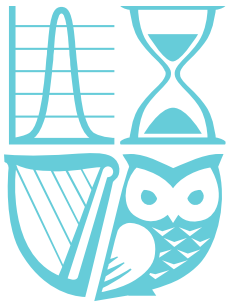

Society of Actuaries in Ireland

Consultation Document on Setting the Discount Rate

Response to Department of Justice and Equality

August 2020

Preface

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland.

Actuaries provide expert evidence on the assessment of compensation for future financial loss to the Courts in many personal injury and fatal accident cases. In addition, the insurance companies which insure defendants in such cases employ actuaries in a number of areas of their business, such as reserving, setting capital requirements and pricing.

The Society welcomes the opportunity to submit this response to the Consultation Document on Setting the Discount Rate issued by the Department of Justice and Equality in June 2020. In preparing this response, our focus has been on the public interest and the responses do not purport to reflect the views of the insurance industry. However, we would point out that any change which increases the level of compensation paid to injured plaintiffs, which is clearly in the best interests of claimants, will lead to increased costs for insurers (and the State where it is the ultimate defendant) which will in turn mean higher premiums for all policyholders.

We would be happy to respond to any questions on this response. Please contact Philip Shier, Head of Actuarial Practice, at philip.shier@actuaries.ie.

General

The Consultation document states that "the intention is not to change the fundamental principle that a claimant should be fully compensated". The objective is to see what, if any, changes need to be made "to the current system of setting the discount rate" and identifies "two key issues on which [the Department is] seeking views -

(i) In determining the discount rate, should it be left to the Judiciary to decide on the appropriate rate on a case by case basis, or should the existing section 24 of the Civil Liability and Courts Act 2004 be amended by introducing principles and policies to allow the Minister for Justice and Equality to determine the rate and review at intervals thereafter?

(ii) As has happened in the UK, is there a need to update the investment strategy that a plaintiff is assumed to take in determining the discount rate?".

The Society confirms its view that the discount rate should be set with the aim to compensate plaintiffs fully for their losses. There may be merit in applying different discount rates to different classes of plaintiff. Clearly a catastrophically injured plaintiff is from a very different cohort than a plaintiff who has experienced a relatively small diminution of income. Currently this differentiation is dealt with by using an alternative rate for care costs.

The process and procedures for setting the discount rate should be both balanced and independent. To date this role has been executed by the Judiciary when cases arise to challenge the appropriate rate. Expert evidence from opposing sides is heard by the presiding Judge prior to their decision. Any decision can be appealed to a higher court (as in the *Gill Russell v HSE* [2015] IECA 236).

The Minister for Justice and Equality currently holds the power to change the rate but has not exercised this right to date. If a future system envisages the Minister exercising this prerogative then it should be in the context of, and on the basis of, advice from a panel of independent experts. Any decision in this context should be reversible or open to change and challenge before the Courts on a case by case basis. We recommend that the legislation provides that a review of the discount rate be undertaken at intervals of 3 to 5 years, with the objective of ensuring that it remained appropriate given market and economic conditions at the time.

2.1 General Questions

1. In determining the discount rate, should it be left to the Judiciary to decide on the appropriate rate on a case by case basis, or should the existing section 24 of the Civil Liability and Courts Act 2004 be amended by introducing principles and policies to allow the Minister for Justice and Equality to determine the rate and review at intervals thereafter? Please provide an explanation for your preference.

It is essential to the functioning of the system that the basis for assessing compensation is stable and predictable. This enables plaintiffs and defendants, and their advisors, to estimate the likely quantum of damages, and this will facilitate settlement in many cases where liability is not an issue. It also means that insurers can have a greater degree of confidence in their case estimates and hence in the calculation of reserves and capital requirements; when there is greater uncertainty, they are required to set aside higher capital which in turn can flow through to higher insurance premiums.

We do not have a strong preference for how this is achieved i.e. whether the discount rate is determined by the Minister or left to the Courts, provided that the rate used is predictable and stable.

2. If you favour updating existing legislation, and introducing principles and policies, can you please provide a view on what you think the investment strategy underpinning the discount rate should be?
Options include:

(i) Maintaining the existing risk averse approach as set out in the Gill Russell V HSE case (low risk investments), or;

(ii) Adopting the approach recently introduced in the UK of determining the rate by reference to expected rates of return on low risk diversified portfolio of investments.

We set out in our answer to question 5 in the Legislation Questions section our comments on the discount rate which should be used in the calculation of lump sum damages for future losses. We consider that the principles adopted should be the same, regardless of whether the rate is determined by the Courts or prescribed by the Minister.

3. Please outline any other options that you think would be feasible for calculating the discount rate explaining why you think these would be appropriate.

None

4. In setting out your favoured option can you please provide supporting evidence of how claimants actually invest their compensation and their reasons for doing so?

We do not have any information on how Plaintiffs invest their compensation, other than the approach adopted by the Courts Service in respect of Wards of Court.

2.2 Legislation Questions

Please indicate

1. Whether the Minister for Justice and Equality should retain the existing power under section 24 of the 2004 Act to set the discount rate.

This power has not yet been used; if the Minister were to set the rate (subject to our answers to the following questions) this may provide stability and predictability.

2. If so, should a panel of experts be established to advise the Minister with regard to the setting of the discount rate?

Yes, we recommend that a panel of experts, which should include one or more actuaries, should be established to advise the Minister if she were to prescribe the rate.

3. In the alternative, should a panel of experts be established to set the discount rate?

We presume that the intention here is that a panel of experts would be instructed to produce a report setting out its recommendations regarding the discount rate(s) to be adopted which could be used by the Courts in determining the appropriate rate in each case. We consider that this would be helpful in achieving stability and predictability of awards, although the parties would still be free to provide expert evidence that alternative rates would be appropriate in the particular case.

4. What principles or policies would you like to see included in the amended legislation?

We recommend that if the Minister is to retain the power to set the discount rate the legislation be amended to require that she consider the advice of the panel of experts before doing so, and to enable the composition and duties of this panel to be specified in regulation.

5. Should the principles and policies underpinning revised legislation assume the profile of the claimant to be:

(i) very risk averse – as is currently the case;

(ii) low risk – a mixed portfolio of balancing low risk investments – as in the UK;

(iii) an ordinary prudent investor;

(iv) another type of investor.

Please give reasons for your response.

A catastrophically injured claimant's investment approach is likely to be more risk averse. Additionally, such a claimant is likely to have the option of a PPO which will eliminate many of the risks.

However, for a less severely injured claimant their approach may be closer to a prudent investor. The claimant's investment requirements will depend on their future life expectation, cash flow requirements and the extent of their injuries. These claimants are likely to pursue an investment strategy linked to either (ii) or (iii) indicated above. Additionally, it is our understanding that the Wards of Courts office may follow a strategy that is closely linked to the investment approach for an investor in (ii) above. This is particularly so when the period of loss continues for more than 10 years.

A portfolio asset allocation approach for an investor should allow consideration for the following:

- Timing of cash flow requirements.
- Life expectation of claimant.
- Duration of costs/losses
- Investment diversification (so as not to be overly exposed to only one asset class).

For illustration, the expected Portfolio Return in the current interest rate (and expected return) environment of three possible investment portfolios is shown:

Sample Risk Portfolios	Assumed Return	LEAST RISK	LOW RISK	MEDIUM RISK
Growth Assets (Equities etc)	4.00%	0%	30%	50%
Corporate Bonds	1.00%	0%	10%	20%
Government Bonds/Cash	0.00%	100%	60%	30%
Portfolio Return*		0.0%	1.3%	2.2%

In order to arrive at the discount rate, appropriate reductions would then need to be made to the above Portfolio Returns to allow for:

- Price inflation (or wage inflation, if appropriate) – we understand the long term market expectation for eurozone price inflation is circa 1.5%,
- Investment management charges – these can range up to 0.5%.

The cost of investment advice can be claimed under a separate heading of loss. Taxation is not an issue for catastrophically injured plaintiffs. For non-catastrophically injured claimants, taxation is allowed implicitly by an adjustment in the discount rate.

The individual level of discount rate has a significant effect on the level of the lump sum. For illustration, we set out the lump sum value of a cost of €100,000 per annum for 15 years or, alternatively, 45 years using various discount rates:

Discount Rate	Term 15 years	Term 45 years
1.50%	€1,344,306	€3,279,587
1.00%	€1,393,426	€3,627,468
0%	€1,500,000	€4,500,000
-1.0%	€1,618,969	€5,690,045
-2.0%	€1,752,089	€7,336,353

It can be seen that, for example, a movement in the discount rate from 1.5% to -2% results in an increase in the lump sum by almost 124% for the 45 year case.

We would emphasise that the figures given above are by way of example only and that further research, including an impact assessment, should be undertaken before a decision is made as to the appropriate discount rate to adopt.

6. Should the courts retain the power to apply a different rate than the rate provided for in legislation?

Yes, the Court should have the ability to depart from the prescribed rate where it considers that the circumstances of the case require that a different rate (higher or lower) be used.

7. Should the Minister (or expert panel) be empowered to set different rates for different classes of case?

We consider that this flexibility would helpful and if it were thought that different rates would be appropriate, this could then be done.

Consideration could be given to using separate rates by plaintiff, type of damage and also duration of loss. A plaintiff with a loss extending for a short period (e.g. 3-5 years) is of a different class from a plaintiff with losses extending out longer (e.g. 50 to 60 years). Consideration of a short-term discount rate and a longer-term rate may be a more appropriate match for these ongoing losses. This is particularly relevant given the current very low (or negative) market rates of interest, and the expectation that rates will revert over the longer term to historical norms.

This use of a dual rate has been signalled by the Lord Chancellor as a potential approach for the UK[1]. We understand that a dual rate is currently in operation in Jersey[2,3].

8. How often should the discount rate be reviewed?

We recommend that a formal review of the appropriateness of the discount rate be undertaken every three to five years, but the Minister should retain the power to call for a special review in the event of issues arising which need to be addressed on a more timely basis.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816819/statement-of-reasons.pdf

[2] https://www.gov.je/Government/PlanningPerformance/Pages/MinisterialDecisions.aspx?docid=FFCF0745-E07F-4FAB-B171-5309A739E511

[3] https://www.weightmans.com/insights/periodical-payments-and-discount-rates-jersey-all-change/

2.3 Periodic Payment Orders (PPO's) Questions

Society support for PPOs

The Society was represented on the Working Group on Medical Negligence Litigation and Periodic Payments established in February 2010 by the President of the High Court and chaired by Mr. Justice Quirke. The Society also submitted a response to the questionnaire issued by the Working Group on Legislation on Periodic Payment Orders in 2014 and met with the Working Group on 22 September 2014.

The Society strongly supports the use of PPOs to provide compensation for future loss (particularly cost of care) in cases of catastrophic personal injury. Our submission to the 2014 Working Group also supported their use in personal injuries claims above a certain cost and in which the person requires long term care.

The Society would support wider use of PPOs for the delivery of compensation for future financial losses as a plaintiff in respect of whom a PPO is granted will, in relation to the future losses covered by the PPO, be protected against the risks of

- lower than expected investment returns,
- higher than expected inflation of those future losses and
- longer than expected life expectancy.

We would recommend that, in all personal injury actions where the present value of future financial losses claimed exceeds a certain threshold, the Court should award damages for such losses in the form of a PPO; this would be consistent with the view that the plaintiff should not be required to take risks in order to receive full compensation for the future losses incurred. Where the plaintiff is less risk averse and wishes to receive lump sum compensation which can be invested in more risky assets, the parties may agree to a lump sum settlement in lieu of the PPO. This should require the approval of the Court in the case of a minor or ward of court.

Allowance for inflation in care costs

One of the recommendations in the Report (Module 1) of the Quirke Working Party is that

(v) Provision within the legislation must be made for adequate and appropriate indexation of periodic payments as an essential prerequisite for their introduction as an appropriate form of compensation.

In particular, the Group recommends the introduction of earnings and costs-related indices which will allow periodic payments to be index-linked to the levels of earnings of treatment and care personnel and to changes in costs of medical and assistive aids and appliances. This will ensure that plaintiffs will be able to afford the cost of treatment and care into the future.

The Society highlighted this issue in its response to the 2014 questionnaire; whilst recognising that it would be difficult to produce an Irish index specifically reflecting medical wages increases, we suggested that "a wide national average wage index may be most appropriate, with a medical element at a suitable weighting".

The Civil Liability (Amendment) Act 2017 contains the statutory provisions in relation to PPOs which came into effect on 1st October 2018. The Act provides "that the annual amount awarded to the plaintiff will be adjusted in accordance with the Harmonised Index of Consumer Prices (HICP) as published by the Central Statistics Office or such other index as may be specified by the Minister under section 51L".

As noted in the consultation document, in November 2019 Ms Justice Deirdre Murphy gave her judgment in *Hegarty (a minor) v HSE [2019] IEHC 788*[4], a test case involving a four-year-old boy who suffered brain injury after his birth in Cork University Maternity Hospital, and in respect of whom liability had been admitted and an interim settlement reached in October 2016. The State Claims Agency sought to deal with the balance of the claim by a PPO, but Ms Justice Murphy, having heard from a range of experts, found that the provision of the Act linking payments under the PPO to the HICP means such plaintiffs will be undercompensated as future care costs are expected to rise faster than price inflation. She said that no judge could approve payments linked to that index.

It is worth noting that in the UK, the allowance to use indexation rates on the PPO payments other than the Retail Prices Index (RPI) introduced in 2008 was one of the driving factors in the increase in PPO numbers at that time. This resulted in a move towards the use of the Annual Survey of Hourly Earnings (ASHE), which is a measure of care workers' salaries. This move in the indexation from the RPI to ASHE made PPOs relatively more attractive.

We note the statement in the consultation document that this issue is under review within the Department and we would reiterate our view that a PPO which provides compensation in respect of future care costs should provide for such costs to be adjusted by reference to an index reflecting the increase in medical wages. We would be happy to contribute to this review if this would be of assistance.

In our responses to the questions below, we assume that the PPO framework will be amended to provide for indexation of care costs by reference to an appropriate index.

9. What impact would changes to the existing discount rate have on the use of periodic payment orders in catastrophic injury cases?

Any reduction in the discount rate makes the lump sum more attractive relative to the PPO and one would therefore expect that fewer plaintiffs would accept a PPO if the discount rates were reduced.

UK experience subsequent to the announcement in February 2017 that the Ogden discount rate used in the UK courts was to be reduced from 2.5% to -0.75% supports this expectation. The Periodical Payment Orders Working Party Update GIRO 2018 Report (Industry Survey)[5] by the Periodical Payment Orders Working Party of the Institute & Faculty of Actuaries noted that

"The number of Motor (non-MIB) claims greater than £1 million settling as a PPO claim in 2017 seems to have been greatly affected by the change to the Ogden discount rate and has continued the decreasing trend observed since settlement year 2012, with a 79.1% reduction since 2015 and a 86.4% reduction since 2012. … The number of Motor (MIB) PPO claims settling as a PPO claim in 2017 has reduced by 63.6% when compared to 2016 levels."

More recent UK experience is presented in "PPOs – What's the market doing?" by Patrick Tingay and Peter Towers (May 2020)[6]. This showed that the number of PPOs settling had stayed at a similar level in 2018.

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[4] https://beta.courts.ie/acc/alfresco/e3fb19c3-20f5-4536-af8a-48eb79556b39/2019_IEHC_788_1.pdf/pdf

[5] https://www.actuaries.org.uk/system/files/field/document/PPOWP%20GIRO%202018%20Report%20Final.pdf

[6] https://www.actuaries.org.uk/system/files/field/document/2020%20Qualitative%20Survey%20-%20PPO%20Workshop%20FINAL%20v1.pdf

Conversely, insurers might be more willing to consider settling a case on the basis of a PPO if they expected that the lump sum which the court might award would be (significantly) greater than at present.

10. Has the decision in Gill Russell vs. HSE made it more or less likely that claimants will utilise PPOs?

As noted above, a reduction in the discount rate, as in the Russell judgment, makes PPOs relatively less attractive to the plaintiff, but as PPOs have only been available since 1 October 2018, and numbers are very small, it is impossible to be certain of the actual impact of the Russell judgment. As noted above, PPOs are currently in abeyance following the judgment in the Hegarty case in November 2019.

2.4 Recent UK Developments Relevancy to Irish Market Questions

11. How relevant is the outcome of the UK consultation on the personal injury discount rate to the Irish market?

In undertaking this review, the Department should consider experience and practice in other jurisdictions. As the legal system in the UK is very similar to that in Ireland, UK experience is most relevant to the Irish market and hence the findings of the recent review in England and Wales, as well as the approaches adopted in Scotland and Northern Ireland, should be taken into account.

Having said that, there are some differences in the Irish market which need to be recognised: the population is much smaller and hence the number of insurance providers, insurance policies and claims will be smaller and this may make some issues more difficult to address – in particular, it is unlikely that the number of cases settled on the basis of PPOs provided by insurers in Ireland will be very high which may inhibit the use of PPOs in cases where they might be considered appropriate. There may also be fewer sources of data; for example, there is currently no Irish equivalent of the ASHE index which might be an appropriate basis for indexation of future care costs. Most importantly in the context of setting a discount rate, the supply of Government bonds linked to Irish inflation is (currently) very small, so that a very risk averse plaintiff might not in practice be able to invest in a portfolio which would meet his/her future needs on a very low-risk basis.

12. What weight should be given to UK experience as part of this review process?

The Society does not have a view on how much weight should be given to the UK experience.

However, we note that the Lord Chancellor, in determining that the discount rate should be -0.25%, considered[7] that an appropriate balance was achieved if the "representative claimant" had a two-thirds chance of receiving full compensation, and a 78% chance of receiving at least 90% compensation, with a relatively low probability of "over-compensation" i.e. where a significant percentage of the damages remained after the end of the expected term.

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7 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816819/statement-of-reasons.pdf

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