Comments on Draft Damages (Jersey) Law

1. I am pleased to have the opportunity of commenting on the Draft Damages (Jersey) Law, which has been put out for consultation. As the former Government Actuary of the United Kingdom I have had a long involvement in the assessment of damages for personal injury and fatal accident claims, including being a member of the Ogden Working Party from 1991 to 2007 and again from 2017. I am also on the Editorial Board of Facts and Figures. Since my retirement from the post of Government Actuary in 2007 I have acted as an expert witness in more than 60 personal injury or similar cases, including the *Helmot v Simon* case in Guernsey, the *Thomson v Thomson* case in Bermuda and the *X Children v MHSS* case recently before the Royal Court of Jersey (and currently awaiting judgement).

2. I am fully supportive of the move to provide in Jersey Law for periodical payments to be an acceptable alternative to lump sum compensation. The proposal to allow changes to the periodical payments when there are material changes in costs will make PPOs much more flexible and appropriate than the PPO legislation in England & Wales, which is unhelpfully restrictive in permitting review only once during the lifetime of the order. This greatly limits their usefulness as a method of providing compensation. PPOs are in principle a much fairer system of compensation for many cases, since they are paid for as long as the claimant remains alive and they do not require estimates to be made of the returns on the investment of compensation amounts. They also avoid the lottery of market behaviour and the difficulties of making optimum investment decisions.

3. However, I am very concerned about the proposal to adopt such high rates for the discount rates in the Jersey Law as are proposed. Considerable reliance appears to have been placed on the report from the Government Actuary's Department of July 2017. However, that report is unsatisfactory in a number of respects. In particular:
   1) The investment portfolios were not selected by GAD but specified by the Ministry of Justice, and cannot by any stretch of the imagination be considered to be low risk portfolios.
   2) The GAD report ignores tax and investment management costs, both of which can have a material impact on the required discount rate.
   3) No consideration is given to the different types of inflation which can arise in personal injury claims, in particular the much higher inflation which can normally be expected to apply to earnings-related heads of damage than price-related heads of damage.

4. The different growth pattern of earnings-related aspects of a claim, in particular for costs of care, are recognised explicitly in PPOs in the UK, where carer costs are generally revalued using the ASHE6115 index of carer earnings, whilst other costs are assumed to go up in line with the Consumer Price Index.

5. Careful consideration was given to the characteristics of a potential low risk portfolio by the panel of experts appointed by the Ministry of Justice (Paul Cox, Richard Cropper, Ian Gunn and John Pollock). Their report of October 2015 was published by the Ministry of Justice as part of their response to the 2017 discount rate consultation. They illustrated two lower risk investment portfolios in Chapter 4. The one which received most support from all the authors was a portfolio constructed as follows:

Investment category	Percentage share
Index-linked gilts	75%
Corporate bonds	12½%
Overseas developed countries index-linked bonds	7½%
Equities	5%

6. At the time they estimated that the expected return on that portfolio would be 0%. It would probably now be negative. Another carefully considered low risk portfolio is that set out in the Damages (Investment Returns and Periodical Payments) (Scotland) Bill.

Investment category	Percentage share
Cash or equivalents	10%
Nominal gilts	15%
Index- Linked Gilts	10%
UK Equities	7½%
Overseas Equities	12½%
High Yield Bonds	5%
Investment Grade Credit	30%
Property	5%
Other types	5%

7. This is materially lower risk than the portfolios which were considered in the GAD paper, which would be regarded by many people as completely inappropriate for the purpose of setting a low risk portfolio for a claimant.

8. Appendix 2 of the Draft Damages (Jersey) Law paper quotes some portfolios from the MSCI Wealth Management Association Private Investor Indices. However, these are misleading in relation to the purpose with which we are concerned, since they do not relate to low risk investors who are solely dependent on the investment portfolio for their future survival, as is normally the case for a claimant.

9. The established Common Law approach to the discount rate, building on the *Wells v Wells* judgement of the House of Lords in 1999, uses the real yields on index-linked gilts (ILGs) as an appropriate market-based measure of the real rate of return. This is not intended to imply that a claimant would be expected to invest in ILGs; the yields are simply an objective market measure of risk-free real return. A decision to invest in different assets may be associated with a higher expected rate of return but

would also have a higher level of embedded risk. It is important for a claimant not to have to take significant risk in order to increase expected returns, since the resulting volatility in market values could cause sequencing issues for a claimant who has to sell assets in order to meet necessary outgoings.

10. The current result of applying the existing Common Law framework is to give a discount rate of −1.5% for price-related heads of damage. This is based on the twelve-month moving average of yields on ILGs up to the end of October 2018. For a very large compensation amount the impact of tax would move the discount rate to −1.75%. Lower discount rates would be appropriate for earnings-related heads of damage (some 1 to 2 % a year lower depending on the view taken on future real earnings growth).

11. The current Civil Liability Bill before the UK Parliament is intended to change the focus of setting the discount rate in England & Wales from very low risk investment to low risk investment. However, no example portfolio is provided so it is still uncertain what the impact of this legislation will be once the first review of the rate under the new rules takes place.

12. I would expect that, with a reasonably conservative investment portfolio, such as the two illustrated above, and proper allowance for investment management expenses and for tax, this could give rise to a discount rate in the range −1% to +½%.

13. I note that it is implicit in the Jersey paper that exemption from tax might be given to investment proceeds from a compensation lump sum. This would be very helpful and would remove the need for a tax adjustment downwards in the discount rate. However, investment management expenses cannot be avoided and are likely to be of the order of +1% a year on funds under management for a mixed portfolio, which is one of the reasons why the discount rate should remain low even under an assumption of low risk investment instead of risk-free investment.

14. In my view it would be entirely inappropriate to set a lower limit to the discount rate of 0%. The discount rate should very likely be below zero in currently foreseeable circumstances, even if there is an intention to move away from a risk-free investment assumption. It should be pointed out that the more one moves away from the risk-free real rate of return, the more likely it is that claimants will not receive 100% compensation.

15. **Conclusion**. Introduction of a Periodical Payment regime, particularly with the review flexibility proposed, will be a significant step forward in enabling a more sensible compensation regime in Jersey for the cases for which PPOs are suitable. Experience in England & Wales is that there remain considerable proportion of case where PPOs are not a suitable mechanism for compensation. The discount rate will, therefore, remain a key element of the Jersey personal injury compensation scene. In my view the case has not yet been made for moving away from a risk-free real rate of return. However, if public policy points in the direction of favouring the

compensators (i.e. generally the perpetrators of the tort) and taking a risk of significantly undercompensating the claimants, then it is essential that the discount rate should reflect returns on a particularly low risk portfolio and make adequate allowance for investment management expenses and tax (if still relevant). I would expect this to lead to a discount rate of no more than 0% in current conditions for price-related heads of damage, and a significantly lower rate for earnings-related heads of damage. Setting a lower limit of 0% real return would therefore be inappropriate and likely to lead to significant under-compensation in many cases.

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