www.mplegal.im

M&P LEGAL

REVIEW

The Effect of Poor Investment Rates on Manx Compensation Awards

back home forward

contact us

March 2017

Advocates, Solicitors & Attorneys
an incorporated legal practice

march 2017

The Effect of Poor Investment Rates on Manx Compensation Awards

As recently reported in the national news, the Lord Chancellor in the UK has set a new "discount rate". This has led to much angst on the part of insurers who recognise that the cost of claims will now be significantly higher, meaning that premiums and government spending on healthcare are likely to need to increase. In this article, I examine what all the fuss is about and whether this applies to us here in the Isle of Man anyway.

What is the discount rate anyway?

Lawyers use actuarial tables to predict future losses when valuing compensation claims, particularly for personal injuries. If we think of a victim who has four years to retirement and who has lost earnings for each of those years. Let us assume that if he had not been injured he would have earned £25,000 in each of those four years. If the defendant insurer is ordered to pay him £100,000 as a lump sum at the outset then the claimant may be overcompensated because he has the benefit of that £100,000 earlier than he would have done if he had been working. To be fair, the law tries to make allowance for inflation, investment returns and also the chance that he might die or lose his job before retirement.

The term "Discount rate" refers to the adjustment that is made to allow for the investment returns that can be made by receiving the money early. The level of the discount is traditionally based on the investment return available on index linked gilts. These are a low risk asset and are theoretically inflation proofed.

What has happened in the UK?

In the UK, the discount rate has been set at 2.5% since 2001. This means that the Courts should assume that a Claimant can make a net investment return after inflation of 2.5% per year. However, Lord Chancellor Liz Truss changed the rate last month to -0.75%.

A negative value such as this implies that, from an investment perspective, it is actually worse to receive the money upfront! Investment returns cannot keep pace with inflation. If you invest it, you will be -0.75% a year worse off after inflation.

The Lord Chancellor argues a negative discount rate is justified because Claimants shouldn't have to invest their money in risky assets but are entitled to choose government backed securities. Her discount rate merely reflects the negative real returns that you can presently get on index linked gilts, averaged over the last three years. She argues she is simply providing fair recompense to Claimants.

Such a large reduction in the Discount Rate has caused fury among insurers and the Lord Chancellor herself was acutely aware of the impact on the amount the NHS pays out in medical negligence claims. Moreover, opponents disagree that you cannot get a return better than inflation without taking unacceptable risks with your capital.

Regardless of the politics, what's clear is that UK awards for future loss will now be higher

The Effect of Poor Investment Rates on Manx Compensation Awards

and some could perhaps even double as a result of this. The longer the period of loss, the greater the effect. Cases involving children with full life care needs will be particularly affected.

What about the Isle of Man?

For many years the Isle of Man Treasury did not set a discount rate so lawyers just used the UK rate. However, in 2009, the Guernsey Court of Appeal in Helmot v Simon [2009/10] GLR 465 decided that this approach wasn't essential and that an individual calculation of investment returns was permissible. Having heard evidence the Court held that the appropriate discount rate for earnings related losses in Guernsey at that time was not the 2.5% set by the Lord Chancellor but rather a stunning -1.5%. There was, following that decision, speculation in the Isle of Man that such an approach would be followed in the Isle of Man and that this was great news for claimants (see my previous article in 2012).

However, in 2014 Tynwald issued the Damages (Personal Injuries) Order 2014 which set the discount rate in the Isle of Man at 2.5%. A legal challenge to depart from this rate failed (see De Yoxall v Moore Judgment 4 August 2015). The discount rate in the Isle of Man remains 2.5%. Unless there is something specific to the individual claimant (which is highly unlikely) the Court will not depart from the rate set by Tynwald.

Thus, for the first time, the Isle of Man is not in line with the UK in this respect. In the UK, the discount rate is now -0.75% - at least it is until such time as the insurers lobby the Westminster Government into increasing it! In contrast, in the Isle of Man, the discount rate remains at 2.5%.

Further comments

This means that a claimant claiming in the Isle of Man might receive considerably lower compensation than a claimant claiming for the same set of circumstances in the adjacent island. There may therefore be a number of unexpected results from this present discrepancy (which of course, Tynwald could end if it wished):-

1. Claimants will have a preference for applying English law; defendants Manx law if there is a choice. However, in most but not all cases, the law that applies is the law of the place where the accident happened;

2. Insurance premiums and healthcare spending on litigation may stay lower in the Isle of Man than in the UK. Certainly, insurers would not have to pass on the increased cost of claims;

3. Litigants should receive Manx legal advice on their claims rather than, as occasionally happens, obtaining advice from English solicitors.

The Effect of Poor Investment Rates on Manx Compensation Awards

Whatever happens, we can be sure that this is not the final word on the subject. Tynwald may come under pressure to follow suit or alternatively the Lord Chancellor in the UK may back down. In any event, investment returns are always shifting which is why some commentators have criticised the UK's lack of clarity on a review date for the discount rate and as to what the rate will be if the base of the assumed investment in gilts is altered. The fact that the discount rate did not change in the UK between 2001 and this month masked considerable differences in the rates of return during that period. It seems likely that a negative discount rate will not survive for long simply because if investment rates improve, the clamour for change from the insurers is likely to become overwhelming. With that in mind, Tynwald might sensibly adopt a wait and see approach.

Advocate Chris Brooks is counsel at M&P Legal. For specialist advice on compensation claims please email him at cmb@mplegal.im.

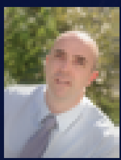
www.mplegal.im

M&P LEGAL

REVIEW

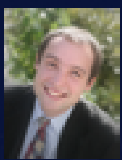
Profiles

Click on a profile to be taken to our web site for full details

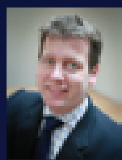


Christopher J Murphy
Joint Managing Director
cjm@mplegal.im

John T Aycock
Joint Managing Director
jta@mplegal.im



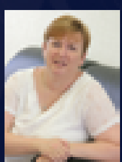
Christopher M Brooks
Counsel
cmb@mplegal.im



Damian P Molyneux
Counsel
dpm@mplegal.im

Nadine V Roberts
Associate
nvr@mplegal.im

Amelia J Quinn
Trainee Advocate
ajq@mplegal.im



Carol A Young
Conveyancing Manager
cay@mplegal.im

Niall M Prentice
Paralegal Assistant
nmp@mplegal.im