



HSS(F) 21/98

The Chief Executive of each Health and Social Services Trust
The Director of Finance of each Health and Social Services Trust
The Chief Executive of each Health and Social Services Board
The Director of Finance of each Health and Social Services Board
The Chief Executive of the Central Services Agency
The Director of Finance of the Central Services Agency
The Chief Executive of the Northern Ireland Blood Transfusion (Special Agency)
The Chief Executive of the Regional Medical Physics Agency

14th May 1998

Dear Sir/Madam

CLINICAL NEGLIGENCE CLAIMS: STRUCTURED SETTLEMENTS

The purpose of this circular is to provide guidance on the use of structured settlements in clinical negligence and personal injury litigation. Structured settlements should always be considered for settlements of £250,000 and above, and may represent good value for money for smaller settlements as well.

Annex A sets out the guidance to be followed.

Yours sincerely

A handwritten signature in black ink, appearing to read 'N. Jones', is written over a horizontal line.

N JONES

Policy and Accounting Unit

CLINICAL NEGLIGENCE AND PERSONAL INJURY LITIGATION: STRUCTURED SETTLEMENTS

EXECUTIVE SUMMARY

1. Structured settlements (settlements of litigation involving the guaranteed payment of a tax-free stream of income over the plaintiff's life) can offer reassurance to plaintiffs and their carers and value for money to the HPSS. They should always be considered for any settlement resulting in costs to the HPSS of £250,000 (exclusive of costs) or over, and may be good value for lower settlements as well.
2. Proposals for structured settlements must be approved by the HSS Executive on the basis of a "value for money" (VFM) report submitted by the Trust. The VFM report may be completed in-house, using the guidance in the Appendix, or by external advisers. The external advisers should be employed in accordance with HSS (F) 20/96 'Use of Management Consultants'.
3. The HSS Executive, Policy and Accounting Unit, should be notified as soon as possible of any claim which is likely at some point in the future to result in a structured settlement.

The Central Services Agency should also be informed as soon as possible of any claim which is likely at some point in the future to be structured, as the settlement will require funding from the Clinical Negligence Central Fund.

BACKGROUND

1. The cost of clinical negligence is an increasing burden on the HPSS. Trusts will wish to consider ways to moderate these costs, including as appropriate:
 - i. adopting prudent risk management strategies;
 - ii. adopting a systematic approach to claims handling in line with best current practice and guidance issued by the HSS Executive (HSS(F) 20/98).
2. Structured settlements are one way of reducing the financial impact of clinical negligence on the HPSS, while offering additional security to plaintiffs. A structured settlement cannot be imposed on either party so clearly there needs to be benefit to both parties for it to proceed.

FEATURES OF A STRUCTURED SETTLEMENT

3. Awards for damages traditionally comprise a single lump sum payment, one element of which ("future loss") is calculated so that, if prudently invested, it would provide a stream of income representing loss of future earnings and/or the need for continued care for the expected remainder of the plaintiff's life. The amount of the lump sum is

agreed by the court either as a result of a hearing or an out-of-court agreement. Structured settlements on the other hand allow for part of the damages to be paid in the form of annual tax-free instalments for the duration of the plaintiff's life.

FORMS OF STRUCTURED SETTLEMENT AVAILABLE

4. There are two forms of structured settlement:
 - i. *Annuity-backed structured settlement.* At the point of settlement the Trust makes a lump sum payment to an insurance company to purchase an annuity for the plaintiff. This will guarantee an annual stream of income for the remainder of the plaintiff's life.
 - ii. *Self-funded structured settlement.* The Trust itself gives an undertaking to make the stream of future payments to the plaintiff out of normal revenue funding.
5. In general, self-funded settlements offer better value for money to the HPSS because they avoid paying for the insurance company's profit element and secure the benefit of spreading the cash flow impact over time (see below). However,
 - i. they might, in the past, have been less acceptable to plaintiffs and their solicitors because of the perceived risk that the HPSS body might at some future time be wound up or merged. This is considered further at paragraph 9-10 below;
 - ii. many HPSS bodies have traditionally been unwilling to take the additional element of risk (ie that the plaintiff will in fact live longer than the life expectancy assumed in calculating the structure).

ADVANTAGES OF STRUCTURED SETTLEMENTS

6. The attraction for the plaintiff is that he/she receives a stream of future payments guaranteed for life, usually index-linked to the Retail Price Index. In addition, provided that the paperwork agrees with the procedure set down by the Inland Revenue, the instalment payments are free from all taxes. A 1994 Law Commission Report strongly supported the use of structured settlements and its main recommendations have now been taken up in the Damages Bill introduced in February 1996. There was also a specific clause in the 1995 Finance Act giving formal recognition to structures and their tax-free status which is now a matter of law. A further advantage for the plaintiff is that the projected settlement can be tailored individually to the plaintiff's needs.
7. The advantage to the HPSS is that structured settlements can offer better value for money than a lump sum settlement. Directly, the HPSS defendant may be able to negotiate a significant discount (compared with a lump sum comparator) in recognition of the tax and other advantages to the plaintiff. Indirectly, the plaintiff's future needs may be better met by regular payments which are more likely to be spent

upon the purposes for which damages were awarded. This should result in a significant reduction in the likelihood of the plaintiff incurring further additional costs to the HPSS. A final advantage (self-funded settlements only) is that the damages no longer need to be paid out in one lump sum and thus the cash flow demands will be spread more evenly over time.

FUNDING OF STRUCTURED SETTLEMENTS

8. When details of a structured settlement, either self-funded or annuity-based, have been formally agreed between the plaintiff(s) and the Trust, the latter should make the relevant payment and seek reimbursement from the Clinical Negligence Central Fund, operated by the Central Services Agency. (See para 4.2 of HSS(F) 19/98).

CONCERNS FROM PLAINTIFFS ABOUT THE SECURITY OF THE ARRANGEMENTS

9. Despite the fact that no public body has ever failed to meet any of its agreed financial obligations there has been concern amongst plaintiffs and their representatives that structured settlements, which could last 40 to 50 years into the future, may not be fully secure. Plaintiffs may seek a binding guarantee from the Department to underwrite the settlement.
10. The HPSS (Residual Liabilities) Northern Ireland Order, which came into force on 26 August 1996 requires the Department of Health and Social Services to make provision for any residual liabilities of a Trust or Board which ceases to exist by transferring them to another HPSS body or the Department. This removes the perceived problem of security.

PROCESS FOR CONSIDERING AND APPROVING STRUCTURED SETTLEMENTS

11. Trusts are fully responsible for their decisions over the handling of clinical negligence and personal injury litigation although central guidance from the HSS Executive must be followed. In particular, Trusts are accountable for securing the best possible value for money in any settlement of litigation. **Structured settlements should always be considered whenever the cost to HPSS funds is likely to exceed £250,000** and may represent good value for money for lower awards also. This figure may be revised in the light of experience. If, on consideration, a structured settlement does not appear to offer value for money, or despite best endeavours the plaintiff is not prepared to accept one, the details should be recorded and made available on request to internal audit and the HSS Executive.
12. All structured settlements require approval from the HSS Executive. If in the view of the Trust a structure might offer value for money, and it appears that the plaintiff may be agreeable, the Trust should:
 - i. ensure that Policy and Accounting Unit of the HSS Executive is notified at the earliest opportunity;

- ii. commission or complete a VFM report in the form set out in the Appendix and submit this to the HSS Executive, Policy and Accounting Unit;
 - iii. inform the Central Services Agency as funding will be required from the Clinical Negligence Central Fund.
13. The VFM report should assess the value for money to the taxpayer as a whole, as well as to the HPSS, comparing the proposed structured settlement with a conventional lump sum award. Both self-funded and annuity-backed structures should be considered. In addition the Trust will need to submit details of:
- i. the statement of claim
 - ii. the Court Order if available
 - iii. a legal opinion on causation
 - iv. a legal opinion on quantum ie the lump sum comparator
 - v. a legal opinion confirming that the value of any discount offered on the structure is the maximum that could be achieved in negotiation or that no discount is appropriate
 - vi. the date of any Court judgement/settlement.

CONSIDERATION OF A STRUCTURED SETTLEMENT

14. It is usual to wait until a provisional agreement on the quantum of damages has been reached before considering the case for a structured settlement, even if certain aspects of the proposed settlement are still in dispute. However, a structured settlement can be considered at any stage in the legal process but should certainly be considered with legal advisers before any offer to settle is made.
15. The overall value for money of a proposed structure may depend on whether a suitable discount can be negotiated. It would therefore be wise to tackle this issue at an early stage in the negotiations.

DISCOUNT AND MINIMUM GUARANTEE PERIODS

16. Discounts are received in recognition of the administrative costs of servicing the structure and the tax advantages to the plaintiff. A discount should always be sought in recognition of these additional costs since it may be critical to the overall value for money for the HPSS.
17. Minimum guarantee periods (ie an undertaking to pay the annuity for a minimum period even if the individual insured dies before the end of the period) are commonly offered by insurance companies when selling annuities. Plaintiffs may therefore ask

for similar minimum guarantee periods for structured settlements, whether annuity-backed or self-funded. The HSS Executive does not believe that such guarantees are appropriate for most clinical negligence cases where the object is to compensate the plaintiff for loss of earnings or to provide for the costs of care during the plaintiff's lifetime. The main exception would be in circumstances in which there are others financially dependent on the plaintiff.

18. Discounts and guarantees have often been linked in negotiations (although there is no inherent reason for this). It is common for one to be given up in consideration for the other. Each case should be considered on its own merits; general advice may be obtained on request from the HSS Executive.

PREPARATION OF THE VALUE FOR MONEY REPORT

19. The Trust may prepare the VFM report in-house if they consider that they have the expertise to do so. This will involve obtaining quotations for annuity-backed structures, preferably from at least 2 insurance companies, and comparing these on a discounted cash flow basis with the cost of a self-funded structure. Trusts are not licensed under the Financial Services Act to obtain quotes from life offices; thus in some respects specialist advice will be required. However, Directors of Finance of Trusts will become increasingly familiar with the workings of such settlements. Alternatively, the VFM report may be commissioned from a specialist accountancy firm. Any external advisers must be employed in accordance with the guidance set out in HSS(F)20/96 "Use of Management Consultants".
20. It is essential that the VFM report submitted to the HSS Executive is based on a position that has already been conditionally agreed with the plaintiff's advisers. As a structured settlement cannot be imposed by either party in the litigation process on the other, then the plaintiffs must equally be satisfied that this form of settlement represents better value for them. The HSS Executive does not have a role in the negotiation.

FACTORS TO BE CONSIDERED IN COMPARING THE OPTIONS

21. The following factors should be taken into account:
 - i. what investment returns would be available to the plaintiff from a lump sum payment (this is needed to compare any excess HPSS care costs for the proposed structure with the lump sum comparator);
 - ii. how long the plaintiff is expected to live;
 - iii. the length of guarantee of payment to the plaintiff;
 - iv. the estimated future costs of care (if any);
 - v. the agreed size of the annual payment under either of the structure options;

- vi. the size of discount negotiated (if any);
- vii. the cost of the insurance company quotations (annuity-backed settlements);
- viii. the estimated loss of taxes to the Treasury under either of the structuring options.

There may be other factors to take account of and the above list is therefore not exhaustive.

- 22. The cost streams on each option should then be compared on a net present value (NPV) basis. Sensitivity analysis should be used to test the robustness of the conclusion to the main uncertainties involved (see paragraph 4 of the Appendix to this Annex).

ROLE OF THE HSS EXECUTIVE

- 23. The HSS Executive will need to be assured that all relevant factors have been considered and that the preferred option does indeed represent best VFM. If the VFM report is deficient the HSS Executive may need to come back to the Trust for additional information. Cases which exceed the HSS Executive's delegated limits in this area will also be forwarded to DFP for approval.

- 24. Provided that a VFM report has been submitted, the HSS Executive will provide initial comments within 15 working days and a final decision within a further 10 working days from receipt of full replies to any queries. Where DFP approval is also required, this will run in sequence to the HSS Executive's approval and will operate to the same timescale. The total approval process therefore should be completed within 30 working days provided all information is provided from the outset.

- 25. Once approval has been given for a structured settlement then

- i. **for annuity-based settlements**

the Trust will be authorised by the HSS Executive to purchase the annuity (insurance) from one of the particular insurance companies. The insurance company will be selected on the basis of the most cost efficient quotations obtained. (For payment and reimbursement procedures - see HSS(F) 19/98, para 4.2).

- ii. **for self-funded settlements**

payment and reimbursement procedures should follow HSS(F) 19/98, para 4.2.

OTHER STEPS REQUIRED TO IMPLEMENT A STRUCTURED SETTLEMENT

26. Preparing the VFM report and securing approval from the HSS Executive is only one aspect. Implementing a structured settlement may involve;
- i. detailed appraisal of the plaintiff's current and future financial needs;
 - ii. formulating a financial package best suited to meet those needs;
 - iii. broking of the markets to identify the most appropriate and the most cost effective annuity and assurance products;
 - iv. negotiating the form of the structure, including the frequency of payments and any guarantee periods;
 - v. assisting in drafting the various orders and agreements for consideration by the lawyers;
 - vi. preparation of all reports required for the approval of the Inland Revenue, the Court and the Court of Protection;
 - vii. attendance at conferences and at Court and advising as necessary;
 - viii. appearing in Court to give evidence;
 - ix. preparation of all documentation required for the purchase of the annuity package;
 - x. monitoring after implementation of the actual working of the structure which has been put in place.
27. Most of these tasks can be subcontracted to specialist accountants. If the Trust chooses to do so they will need to consider whether to pay;
- i. a fixed fee for specified tasks whether the work results in a successful structure or not;
 - ii. time related fees for specified tasks whether the work results in a successful structure or not;
 - iii. contingent fixed fee for specified tasks (ie no cost if no structure results);
 - iv. contingent commission (expressed as a percentage of the value of the structure) for specified components.

28. However the work is to be performed, the parties should agree as early as possible which functions should be carried out by whom and on what basis to avoid unnecessary duplication of costs.

Any external advisers must be employed in accordance with the guidance set out in HSS(F) 20/96 "Use of Management Consultants".

APPENDIX 1

STRUCTURED SETTLEMENTS: VALUE FOR MONEY REPORT

Introduction

1. There is no fixed format for the value for money (VFM) report since the details will vary from case to case. However, certain essentials need to be included in every case.

Documentation Required

2. As already stated in the Annex, the following documents are required as well as the VFM report itself:
 - i. the statement of claim
 - ii. copy of the Court Order if available
 - iii. a legal opinion on causation
 - iv. a legal opinion on quantum ie the lump sum comparator
 - v. a legal opinion confirming that the value of any discount offered on the structure is the maximum that could be achieved in negotiation
 - vi. the date of any Court judgement/settlement.

If a structured settlement is negotiated prior to judgement then paragraph 2(vi) will be waived.

Contents of VFM Report

3. The VFM report must incorporate the following information:
 - i. Quantum - the VFM report figure must be supported by appropriate legal advice and any difference fully explained.
 - ii. Discount - full details should be given with an assurance that the Trust has negotiated the maximum possible (or if no discount, that in the overall circumstances of the negotiation why it was not possible to secure one).
 - iii. Guarantee period - full details of any guarantee period should be given, especially in the unusual case of a period extending beyond the expected lifetime of the plaintiff.

- iv. Life expectancy - the figures quoted in the report must correspond with expert opinion from both sides. If there is a significant discrepancy between the two sides the reason for the final weighting (usually by percentage) must be explained.
- v. The assumed composition of the lump sum comparator. This will in general consist of 3 elements (bearing in mind that, subject in the case of patients to any oversight by the Court of Protection, the sum may actually be spent in any way the plaintiff chooses):
 - a. an amount to cover capital equipment needs (eg adaptations to the plaintiff's house);
 - b. a "contingency fund" which (in the case of patients) will be at the disposal of the Court of Protection;
 - c. a sum sufficient to provide for the plaintiff's estimated care needs for his/her expected lifetime (the expiry date for this component must cover the life expectancy and if it does not an explanation must be provided).
- vi. The cost of an annuity sufficient to cover the plaintiff's estimated care costs at c. above.
- vii. The proposed self-funded structure - in general the lump sum element will correspond to elements a. and b. above and the annual payments to the estimated care costs at c. Any deviations should be explained.

The report must make clear that both sides have agreed to the proposals both for the annuity-based structure and (if acceptable) the self-funded structure.

VFM Calculations

- 4. Once the basic data has been explained, the report should compare the net present value (NPV) of the 3 options, namely the conventional lump sum settlement and the annuity-backed and self-funded structured settlements. There are certain mandatory parameters which will be reviewed periodically:
 - i. the discount rate used to calculate the NPV of future cash flows should be set at 6% (unearned return on money);
 - ii. the general rate of inflation should be taken as 2.5%;
 - iii. costs of care should be assumed to rise by 2% per annum faster than the general rate of inflation;
 - iv. Investment assumptions.

Where assumptions are used in the calculations, or if any of the figures for costs are subject to uncertainty, then the calculations should be subjected to sensitivity analysis. This should use plausible ranges of assumptions or important uncertainties to identify possible effects on the merits of the options being compared.

5. The calculation for each of the options should then proceed as follows:

A. Unstructured or Lump Sum Settlement

The public sector pays a single lump sum to the plaintiff (A) (the lump sum comparator) and pays for any care the plaintiff receives when this lump sum expires (B). The public sector also receives income tax which is paid on the income generated by the investment of the lump sum (C). No fees are paid to the settlement advisors.

$$\text{Cost} = A + B - C.$$

B. Annuity-Backed Structured Settlement

The public sector pays a lump sum to the plaintiff (D) and provides for the purchase of an annuity from a life office (E). The public sector also pays for any care costs incurred by the HPSS which are not met by the annual income from the annuity (F). No tax is paid on the structured settlement. Fees for the advisors are paid by the Life Office.

$$\text{Cost} = D + E + F.$$

C. Self-funded Structured Settlement

The public sector pays a lump sum to the plaintiff (D) and makes additional payments until the death of the plaintiff (or for the length of any guarantee period). The public sector self-funds these payments and the expected NPV of these is (G). The public sector also pays for any care costs incurred by HPSS which are not met by the annual payments (F). Fees for the settlement advisors are paid by the public sector (H).

$$\text{Cost} = D + G + F + H.$$