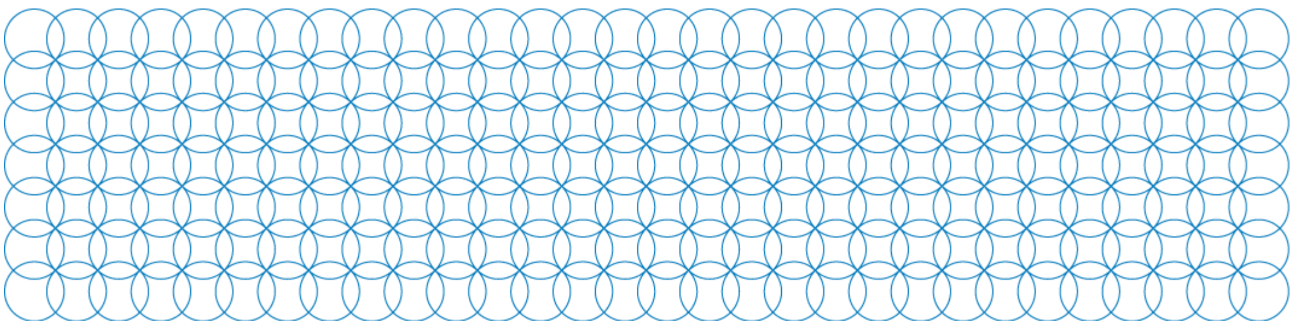
The Personal Injury Discount Rate

How it should be set in future

This consultation begins on 30 March 2017

This consultation ends on 11 May 2017



Ministry of Justice

Scottish Government
Riaghaltas na h-Alba
gov.scot

The Personal Injury Discount Rate

How it should be set in future

A joint consultation produced by the Ministry of Justice and the Scottish Government. It is also available at https://consult.justice.gov.uk/

About this consultation

To:	All those with an interest in personal injury claims
Duration:	From 30/03/17 to 11/05/17
Enquiries (including requests for the paper in an alternative format) to:	Damages Discount Rate Consultation Ministry of Justice 3rd Floor 102 Petty France London SW1H 9AJ Email: damagesdiscountrate@justice.gsi.gov.uk
Enquiries relating specifically to Scotland	Justice Directorate, St Andrew's House, Regent Road, Edinburgh EH1 3DG Tel: 0131 244 6931 Email: damages@scotland.gsi.gov.uk
How to respond:	Please send your response by 11 May 2017 to: Damages Discount Rate Consultation Ministry of Justice 102 Petty France London SW1H 9AJ Email: damagesdiscountrate@justice.gsi.gov.uk Please note that all formal responses will be shared by the Ministry of Justice with the Scottish Government's Justice Directorate and may be shared with the Department of Justice in Northern Ireland.
Response paper:	A response to this consultation exercise is due to be published by 03/08/17 at: http://www.justice.gov.uk and http://www.scotland.gov.uk

Contents

Foreword	3
Executive summary	4
Introduction	6
Background	7
What should determine how the rate is set?	16
When should the rate be set?	27
Who should set the rate?	30
Periodical Payment Orders	33
Questionnaire	38
Annex 1 – Named Consultees	42
About you	45
Contact details/How to respond	46
Impact Assessment	48
Welsh Language Impact Test	49
Equalities Statement	50
Consultation principles	54

Foreword

Fairness for all lies at the heart of our justice system, and we must have a system that works for the whole of society.

It is a longstanding and basic principle in common law that when someone is wrongfully injured, they should be paid damages that compensate them fully for their injuries. The idea is to put them in the same position that they would have been in if they had not been injured, to the greatest extent possible. That means a claimant being paid no less than they should be, and no more. I remain absolutely committed to the principle of full compensation – the '100% principle'.

But for the courts, determining precisely what will provide full compensation for claimants, many of whom are among the most vulnerable people in society, is no easy matter. The future is inherently uncertain, we cannot know precisely how the costs of someone's care will go up or down, we cannot always know what sort of earnings and pension they have lost out on, and we cannot always make accurate predictions about the way inflation will affect a sum of money. We do, however, know that where the award of damages includes compensation for future losses, some adjustment must be made to allow for the possibility that the claimant may invest the award. This adjustment is made by applying a discount rate.

I want to make sure that the way in which the discount rate is set remains fit for purpose. That is why I, together with the Scottish Government, am inviting views on how the rate should be set, how frequently it should be reviewed and by whom it should be set. I also want to consider whether periodical payment orders might be a better way to compensate for future financial loss in more cases than at present. Whilst the legal framework in relation to periodical payments orders is different in Scotland, Scottish Ministers are interested in views on this.

Awards of damages for life changing personal injuries are necessarily going to be very large in some cases, but in the interests of society as a whole and the services that underpin it, I want to be sure that the system of compensation is one that compensates claimants properly, but is fair to consumers, business and taxpayers.

I welcome responses from everyone interested in this topic. Subject to the responses I receive, I would propose to legislate to make sure that the way the rate is set is put on the firmest possible footing in future so that we have a better and fairer system for claimants and defendants.

Rt Hon Elizabeth Truss MP
Lord Chancellor and Secretary of State for Justice

Executive summary

The personal injury discount rate prescribed by the Lord Chancellor and her counterparts in Scotland under section 1 of the Damages Act 1996 provides a relatively straightforward and simple way of avoiding complex and costly litigation as to what the discount rate should be in individual cases. The rate, which has to be taken into account by the court in assessing the size of a lump sum award of damages for future financial loss in a personal injury case, was recently reduced by the Lord Chancellor, acting in accordance with the present law, from 2.5% to minus 0.75%. This change was announced on 27 February and came into force on 20 March. It is expected to increase significantly the size of awards of damages for future loss. Scottish Ministers laid an Order on 27 March to change the discount rate in Scotland to minus 0.75%. The change came into force on 28 March.

The change of the rate has led to renewed calls for a re-consideration of the way the rate is set. Concerns have been raised that the present method, which derives from principles established in the 1998 House of Lords case *Wells v Wells*, is flawed. The main criticism is that this approach intrinsically over-compensates many claimants[1], contrary to the overall objective of an award of damages, namely to meet in full the costs and losses caused to the claimant by the injury, neither more nor less.

The consultation forms part of the review of the framework under which the rate is set that was also announced by the Lord Chancellor on 27 February. The paper considers possibilities for how, when and by whom the discount rate in relation to personal injury claims in England and Wales and in Scotland should be set, but does not make specific proposals. Scottish Ministers are consulting jointly on this review of the framework.

The core issues examined in the consultation paper are:

- **What principles should guide how the rate is set?** Are the present principles still fit for purpose? What should the principles be? What investment returns should be taken into account in setting the rate? Should the possibility of a periodical payment order affect the decision as to the relevant investments?
- **How often should the rate be set?** Should this be left open, as now, or would a set pattern of review be better? Would an annual, three year or five year system be better? Should reviews be triggered by degrees of change in investment returns?
- **Who should set the discount rate?** Should the power to do so remain with the Lord Chancellor and her counterparts in Scotland, or would it be better for someone else, possibly an expert panel, to set the rate?

The paper also considers whether sufficient use is being made of periodical payment orders, which, from the claimant's perspective, remove much if not all of the risk associated with ensuring that the anticipated future financial loss is met in full and on time. Whilst the legal framework in relation to periodical payment orders is different in Scotland, Scottish Ministers are interested in views on this.

---

[1] In Scotland, "claimant" should be read as "pursuer" and "defendant" as "defender"

The aim of the paper is:

- to obtain evidence of how claimants actually invest awards of damages for future financial loss and how they are advised to invest;
- to invite views on what (if anything) should be done to make the system for the setting of the personal injury discount rate better and fairer; and
- to obtain evidence on the use of periodical payment orders and to invite views on whether, and if so how, their use instead of lump sum awards of damages for future financial loss should be encouraged.

The responses to the consultation will help inform both Governments' reviews of the framework for setting the rate.

Introduction

This paper sets out for consultation provisional proposals and questions relating to the personal injury discount rate currently prescribed by the Lord Chancellor and by her counterparts in Scotland. The proposals and questions relate to three principal themes:

- Who should set the discount rate?
- How often should the rate be set?
- What principles should guide how the rate is set**?**

The consultation relates to the law of England and Wales and to the law in Scotland, and is aimed at people and organisations with an interest in personal injury claims.

A Welsh language version of the executive summary will be available at http://www.justice.gov.uk/publications/corporate-reports/moj/2010/welsh-language-scheme

An Impact Assessment has been prepared and is available with this consultation paper. Comments on the Impact Assessment are very welcome. An equalities statement has also been prepared.

A summary of responses to the 2013 consultation paper "Damages Act 1996: The Discount Rate: Review of the Legal Framework" is available at https://consult.justice.gov.uk/digital-communications/damages-act-1996-the-discount-rate-review-of-the/

Copies of the consultation paper are being sent to the organisations named in Annex 1. Responses are welcomed from anyone with an interest in or views on the subject covered by the paper.

Background

The Present Position

1. The personal injury discount rate is set by the Lord Chancellor and by her counterparts in Scotland under section 1 of the Damages Act 1996, in accordance with legal principles set out in case law, in particular the House of Lords decision in the case of *Wells v Wells*.[2] Working out what the rate should be is a technical and demanding exercise. It is also controversial. Almost any change in the rate is likely to provoke different and opposite reactions from claimants and defendants.

2. As Lord Hutton observed at the conclusion of his judgment in *Wells v Wells*:

> *"The consequence of the present judgments of this House will be a very substantial rise in the level of awards to plaintiffs who by reason of the negligence of others sustain very grave injuries requiring nursing care in future years and causing a loss of future earning capacity, and there will be resultant increases in insurance premiums. But under the present principles of law governing the assessment of damages which provide that injured persons should receive full compensation plaintiffs are entitled to such increased awards. If the law is to be changed it can only be done by Parliament which, unlike the judges, is in a position to balance the many social, financial and economic factors which would have to be considered if such a change were contemplated."*

3. On 27 February of this year, the Lord Chancellor announced that she was setting the discount rate for England and Wales at minus 0.75% with effect from 20 March. Scottish Ministers laid an Order on 27 March to change the discount rate in Scotland to minus 0.75%. The change came into force on 28 March.

> Text of Lord Chancellor's Written Ministerial Statement, 27 February 2017 (extract)
>
> *"Having completed the process of statutory consultation, I am satisfied that the rate should be based on a three year average of real returns on Index Linked Gilts. Therefore I am setting it at minus 0.75%. A full statement of reasons, explaining how I have decided upon this rate, will be placed in the Libraries of both Houses of Parliament. The Statutory Instrument to effect this change will be laid today, and will become effective on 20 March 2017.*
>
> *There will clearly be significant implications across the public and private sector. The Government has committed to ensuring that the NHS Litigation Authority has appropriate funding to cover changes to hospitals' clinical negligence costs. The Department of Health will also work closely with General Practitioners (GPs) and Medical Defence Organisations to ensure that appropriate funding is available to meet additional costs to GPs, recognising the crucial role they play in the delivery of NHS care.*

[2] [1999] 1 AC 345

> *The Government will review the framework under which I have set the rate today to ensure that it remains fit for purpose in the future. I will bring forward a consultation before Easter that will consider options for reform including: whether the rate should in future be set by an independent body; whether more frequent reviews would improve predictability and certainty for all parties; and whether the methodology – which in effect assumes that claimants would invest only in index-linked gilts – is appropriate for the future. Following the consultation, which will consider whether there is a better or fairer framework for claimants and defendants, the Government will bring forward any necessary legislation at an early stage.*
>
> *I recognise the impacts this decision will have on the insurance industry. My Rt. Hon. Friend the Chancellor will meet with insurance industry representatives to discuss the situation."*

4. This consultation paper forms part of the first stage of both Governments' reviews of how the discount rate should be set in the future. The review aims to find out if there is a better and fairer way in which the discount rate should be set. The paper invites views on the issues covered and evidence of how awards of damages are invested. During the consultation period the Ministry of Justice will engage with experts and stakeholders and carry out research and other inquiries. Final decisions on any changes to the law will be made in the light of the response to the consultation and other evidence.

5. The discount rate is applied in the context of the law of damages for personal injury claims. In the following three text boxes we summarise the general aim of the law of damages, the purpose of the discount rate and how the rate is applied in practice.

> *Law of damages*
>
> The civil legal remedy for wrongfully inflicted personal injury is usually an award of damages. The award will be to cover all the losses flowing from the injury, whether they be past, present or future, certain or contingent. Examples of damages for future loss or expense include compensation for loss of earnings, care costs, case management costs and medical expenses. These future losses and expenses may in some cases run for many years into the future.
>
> The award for future loss or expense may take the form of a lump sum, periodical payments or a combination of both. A lump sum award should be exhausted at the end of the period for which it is given. Periodical payments should run for the period that the anticipated loss or expense in question is expected to continue or until the death of the claimant, if that is earlier. On the other hand, if awarded for life, actual longevity may exceed expected longevity at the time of the award.
>
> The overall aim is that the award as a whole, whether lump sum or periodical payments or a combination of both, will neither under-compensate nor over-compensate the claimant. As Lord Hope of Craighead said in *Wells v Wells*: "...the object of the award of damages for future expenditure is to place the injured party as nearly as possible in the same financial position he or she would have been in

but for the accident. The aim is to award such a sum of money as will amount to no more, and at the same time no less, than the net loss…”.[3]

This is the “100% rule”. Achieving full compensation may sound a precise formulation but the assessment of damages can never be an exact science, particularly in matching future loss, where predictions have inevitably to be based on assumptions as to what may happen in the future. These predictions may turn out to be inaccurate.

Typically, the award will be calculated by reference to different heads of loss: for example, loss of earnings, costs of care and accommodation expenses; and the periods to which they relate.

Purpose of discount rate

The discount rate forms part of a calculation which converts an assumed future stream of income into a present lump sum. If no discount rate were to be applied to a lump sum award of damages paid at the time of the conclusion of the claim no account would be taken of the effect of the accelerated receipt of the monies due on the adequacy of the compensation. This would be unfair because a claimant might be able to invest the money until it is needed and earn a considerable profit – being over-compensated rather than fully compensated. Equally, assuming that a claimant would not invest would leave the award subject to inflation.

The prescribed rate must be taken into account in all cases in which the court has to determine the return to be expected from the investment of a sum awarded as damages for future financial loss in a personal injury action on or after that date, irrespective of when the injury occurred, the cause of action arose or the proceedings began.

The court is able to take a different rate into account if persuaded by a party that it is more appropriate to do so. The Court of Appeal has, however, held that this power is to be reserved for cases falling into a category of cases, or containing special features, that the Lord Chancellor did not take into account in setting the discount rate (*Warriner v Warriner*).[4] This power has apparently only been exercised once and that was in the first instance decision overturned on appeal in the case of *Warriner v Warriner* itself.

Applying the discount rate

Identifying and applying the discount rate in relation to an individual case is in theory a complicated exercise. In practice, the use of a prescribed rate and the Ogden Tables has the effect of automatically applying a discount rate because different figures are given in the Ogden Tables for different rates of return.

[3] [1999] 1 AC 34 (page 390A-B)

[4] [2002] EWCA Civ 81; 2002 1 WLR 1703

6. In the following boxes we describe how the rate has been set and its recent history.

Setting the rate

The rate must be set in accordance with the Damages Act 1996 and the applicable legal principles set out in case law, particularly *Wells v Wells*. As Lord Hope said in that case: "[The discount rate] is the rate of interest to be expected where the investment is without risk, there being no question about the availability of the money when the investor requires repayment of the capital and there being no question of loss due to inflation." This approach leads to the assumption that for the purposes of setting the rate the claimant is assumed to be very risk averse. It is irrelevant for these purposes what claimants actually do with the award. The court in applying the rate is seeking to calculate how much money the claimant ought to receive to satisfy the expected costs and losses.

The principles in *Wells v Wells* led Lord Irvine in 2001 and the present Lord Chancellor in 2017 to base the discount rate on the investment portfolio that offers the least risk to personal injury claimant investors in protecting an award of damages against inflation and against market risk. They both took the view that a portfolio that contains 100% ILGS best meets that criterion. Scottish Ministers share that view.

In setting the rate the Lord Chancellor and her counterparts in Scotland cannot be influenced by the effect of the change in the rate on defendants. To do so would be to address the wrong question. The rate is set to ascertain what claimants are expected to need to meet their losses given present understanding of future investment returns. In its present form, therefore, assuming that the rate itself is "correct", the rate protects both claimants and defendants equally.

Under the present law the rate chosen is currently based on returns from index-linked investments. This is intended to ensure that the calculation carried out by applying the rate will produce as accurate a result as is possible, in the sense that under the award calculation it will produce the anticipated compensation at the times it is required without shortfall.

How the discount rate has changed

Up until the late 1990s, the courts applied a discount rate of 4.5% (net of tax) loosely based on the assumed return from a mixed portfolio of investments. But in 1998 the House of Lords (in the case of *Wells v Wells*) reviewed the previous case law and identified a set of principles on which the setting of the discount rate should be approached, and on the basis of those principles set the discount rate lower, at 3%, by reference to a three year average rate of return on Index-Linked Government Stock ("ILGS"), a type of gilt introduced in 1981,

The Law Lords' view was that this type of financial instrument represented a virtually risk-free investment, specifically designed to keep pace with inflation. This meant it was the best point of reference for the court, in considering the rate of return to be assumed to be expected by an investor who often had to rely on the lump sum and any return on its investment for a long period of time - sometimes the rest of their life, with quite possibly no other form of income. In reaching their decision the Law Lords reversed the decision of the Court of Appeal, which had

decided claimants should be treated as ordinary prudent investors who would invest in a range of investments including equities as well as ILGS.

By the time of the House of Lords judgment in *Wells v Wells*, the Damages Act 1996 (implementing, with some changes, the recommendations of the Law Commission) had given the Lord Chancellor the power to set the discount rate. The purpose of creating a prescribed rate to which the courts have to have regard was essentially to avoid detailed – and quite probably expensive – expert evidence and argument specific to the case in question as to what the rate should be. Prescribing a rate thereby makes the administration of justice more efficient overall. The power was given to the Lord Chancellor as the court was not in a position to take expert evidence as to what the rate should be in the round.

The power was first used in 2001, when the then Lord Chancellor, Lord Irvine of Lairg, followed the principles set out in *Wells v Wells* to set the rate, by reference to returns on ILGS, at 2.5%. This was a real rate (i.e. 2.5% above inflation). It applied in England and Wales and Northern Ireland. In the following year Scottish Ministers also set the rate at 2.5%.

Following a steady decline in returns from ILGS the Ministry of Justice, the Scottish Government and the Department of Justice in Northern Ireland, issued a consultation paper in August 2012 on how the rate should be set under the present law, but the response to the consultation was inconclusive. In 2015 the then Lord Chancellor, Chris Grayling, and his counterparts in Scotland and Northern Ireland decided to seek advice from a specially commissioned three person panel of experts. The panel completed its work in January 2016.

On 27 February 2017, following the continued decline in returns from the relevant investments, the Lord Chancellor used her power under the 1996 Act to change the discount rate in England and Wales. Using largely the same principles and methodology as Lord Irvine, this new discount rate, which came into force on 20 March 2017, was set at minus 0.75%. Scottish Ministers laid an Order on 27 March to change the discount rate in Scotland to minus 0.75%. The change came into force on 28 March.

7. The change of the rate in 2017 is expected to have material financial effects on claimants, some of whose awards are expected to increase significantly.

8. The effect of a change in the discount rate is so pronounced because of the working of the principles of compound interest on payments to be made over potentially very long periods. For example, if £100k is invested in a portfolio with an average annual real return of 2.5%, the portfolio will have a real value of £128k after ten years and £269k after 40 years. Invested in a portfolio with an average annual real return of minus 0.75%, the real value of the £100k will be £93k in ten years and £74k in 40 years. That is, a negative return (with respect to inflation) erodes the real value of the portfolio and the effect is greater the longer the term of the investment. This means that, if the investor needs £100k in 10 years, in real terms, he or she should invest £108k if expected to invest in a portfolio with a minus 0.75% real return. If the investor needs £100k in 40 years, in real terms, he or she should invest £135k at the same real return. The difference in capital requirement is particularly pronounced in times of low interest rates. To set these principles in context the following text box gives examples of how the recent change in the rate may affect awards.

Claimants: An 18-year-old claimant who suffers a catastrophic injury in a road traffic accident is rendered quadriplegic. She requires 18 hours of daytime care, a night sleeper, some one-off equipment costs and increased care needs in later life. The annual care costs of such a claimant could typically exceed £100k. At 2.5% the total award of a claimant of this type of claim would receive a lump sum of maybe £5m to £6m. At a minus 0.75% discount rate this award could be around £9m, meaning perhaps a 60% increase in the lump sum.

The impact of a change in the discount rate can still be significant for older claimants whose earnings potential may suffer post-injury. A claimant aged 38 at the date of trial, with a predicted retirement age of 67 suffers an injury and is left with a disability after the accident. Due to permanent disability, the claimant suffers immediate income loss of (only) around £1k per year. However, owing to post-accident vulnerability on the labour market assumed by the courts for disabled individuals, much of the post-injury earnings is routinely ignored for the sake of calculating earnings compensation. Consequently, the earnings compensation lump sum of such a claimant would be £215k based on a discount rate of 2.5% using standard actuarial tables. The award would approach £350k if the discount rate were minus 0.75%, which means around 60% increase in the lump sum award.

9. The change in the rate has a converse effect on defendants, some of the costs of which will be passed onto third parties, such as consumers, business and taxpayers.

10. As an illustration, the effects on consumers, businesses and taxpayers of the recent change in the discount rate from 2.5% to minus 0.75% as reported in the media are outlined in the following box.

Consumers

Price Waterhouse Coopers “anticipate an increase of £50-£75 on an average comprehensive motor insurance policy, with higher increases for younger and older drivers – potentially up to £1,000 for younger drivers (18-22 year olds) and a rise of up to £300 for older drivers (over 65 years old)”.[5]

Insurers

According to the Office for Budget Responsibility the Prudential Regulation Authority estimated as at 27 February 2017 the cost to insurers of the Lord Chancellor’s decision to change the rate at around £2 billion a year, with a wide range of uncertainty around that figure.[6]

Price Waterhouse Coopers said “many insurers will need to further increase their reserves, potentially impacting expected results for year-end 2017”. According to Reuters, Admiral saw a fall in their pre-tax profits to £284.3m from £376.8m in

[5] Ogden rate change - PwC comments on impacts for motor insurance pricing. http://pwc.blogs.com/press_room/2017/02/ogden-rate-change-pwc-comments-on-impacts-for-motor-insurance-pricing.html

[6] Economic and fiscal outlook, March 2017. http://cdn.budgetresponsibility.org.uk/March2017EFO-231.pdf

2015[7] and Direct Line realised a fall in their operating profit from continuing operations from £520.7m a year earlier to £403.5m for the year ended Dec 2016. Direct Line's operating profit would have been £578.6 million without the discount rate change[8]. Aviva also announced that it "expects to take an exceptional charge to its 2016 [International Finance Reporting Standards] profit after tax of approximately £385 million, representing the full impact of the move to minus 0.75% as at year end."

Public sector

According to the Office for Budget Responsibility, "the Government has set aside an extra £1.2 billion a year to meet the expected costs to the public sector (notably to the NHS Litigation Authority)."[9]

11. These are significant additional costs for the public and private sectors and they flow from the application of the present law. It is therefore legitimate to examine the basis on which the discount rate is set. This is not to say that the present law is unjust, but to question the assumptions on which it is based. As Lord Lloyd said in Wells v Wells: "Investment in ILGS is the most accurate way of calculating the present value of the loss which the plaintiffs will actually suffer in real terms. Although this will result in a heavier burden on these defendants, and, if the principle is applied across the board, on the insurance industry in general, I can see nothing unjust." The court is simply not best placed to be able to carry out wider societal balancing exercises: as Lord Scarman said "There is no room here for considering the consequences of a high award upon the wrongdoer or those who finance him. And, if there were room for any such consideration, upon what principle, or by what criterion, is the judge to determine the extent to which he is to diminish upon this ground the compensation payable?"[10]

12. The judge may not be able to do so but Parliament can make judgments as to the balance to be struck between different interests. In essence, in this paper, we are asking whether the discount rate as currently set is the best way of effecting the 100% compensation rule.

13. In considering these issues, we are in this paper only concerned with the setting of the discount rate, not with the calculation of the sum to which it is applied. We are not reviewing the underlying principle of the law of damages that the award of damages should, as far as it is possible for an award of a sum of money to do so compensate the claimant fully for all the losses caused to him or her by the injury inflicted by the defendant. The 100% rule will continue to apply.

---

[7] Admiral profit hit by cut in UK injury discount rate. http://uk.reuters.com/article/uk-admiral-group-results-idUKKBN16F0P4

[8] Direct Line sees little 2017 profit impact from discount rate change – CFO.http://uk.reuters.com/article/uk-direct-line-results-idUKKBN16E0Q4

[9]Economic and fiscal outlook, March 2017. http://cdn.budgetresponsibility.org.uk/March2017EFO-231.pdf

[10] Lim Poh Choo v Islington Area Health Authority [1980] AC 174)

Periodical Payment Orders

14. The discount rate plays an essential part in the working of the law of damages where lump sum awards are made for future loss. Awards of damages can, however, also be made by way of secure periodical payment orders (PPOs). PPOs are more fully described in the section of this paper headed *Periodical Payment Orders*. We understand that on the whole, claims against insurers generally have been more likely to settle on a lump sum basis, although it depends heavily on the type of claim, with the largest claims being more likely than smaller claims to settle on a PPO basis. PPOs are heavily used for future costs of care by the NHS Litigation Authority and the Motor Insurers Bureau. It is not yet clear whether the change in the discount rate will make PPOs more attractive, but given that PPOs are more likely to match the expected costs and losses included in the award than a discounted lump sum, and so are in principle less risky than lump sum awards for claimants, there is a question whether the law provides the optimum balance between PPOs and lump sums.

15. PPOs pass the risk of future provision to the defendant without exposing the claimant to any significant risk of the defendant being unable to pay in the future. They thereby remove the need for the court to consider a discount rate. They are a more accurate way to provide compensation, but clearly they come at a cost to the defendant.

16. In this paper we examine two issues relating to PPOs: whether the possibility of a PPO should affect the discount rate and whether any steps should be taken to encourage the use of PPOs as an alternative way to pay an award of damages for future loss. Whilst the legal framework in relation to periodical payment orders is different in Scotland, Scottish Ministers are interested in views on this.

Previous Consultations

17. This consultation is not the first time that issues relating to the setting of the discount rate or the usage of PPOs have been considered. A consultation paper was issued by the Ministry of Justice, the Scottish Government and the Department of Justice in Northern Ireland in 2013 on reviewing the legal framework.[11] The responses were analysed for their perspectives on whether the legal parameters governing the way in which the discount rate is currently calculated are effective in ensuring as far as is reasonably possible that the injured person is fully compensated without either over-compensation or under-compensation; and on whether the use of periodical payments could usefully be encouraged further than is the case under the current law. On the first issue widely diverging views were expressed by different interest groups, and overall the responses demonstrated very little consensus on whether the current legal parameters were appropriate. 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. A summary of the responses to the 2013 consultation paper has been published.[12]

18. Following the inconclusive outcome of the 2012 consultation on how the discount rate should be set under the present law the then Lord Chancellor, Chris Grayling, jointly with his counterparts in Scotland and Northern Ireland, appointed an expert panel to advise on how the discount rate should be set under the present law. In advising, the

---

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

[12] ibid

panel considered a range of options as to what level of investment risk it is appropriate to assume a personal injury claimant is prepared to take with the lump sum. They unanimously agreed that it would be appropriate to set the discount rate by reference to "risk free" returns, such as ILGS, without regard to the actual investments made. This would be in line with actuarial practice.[13] Using such a rate would most closely match the outcome for a claimant in respect of a PPO.[14] However, they also considered a number of possible investment approaches using a financial economics approach. They concluded that not all of these were consistent with the legal principles presently governing the Lord Chancellor's choice. In particular, they rejected basing the rate on 100% investment in an optimal or best risk portfolio[15] assembled on modern portfolio theory techniques offering a balance between return and risk. They did, however, consider that the risk in such a portfolio could be moderated by combining it with real risk free investments; and reached some agreement that up to 25% of the portfolio could be allocated to non-risk free assets. However, only a minority considered that somewhere between 25% and 50% could be non-risk free.[16] We draw on their report in the paper.

Other Jurisdictions

19. Lump sum damages for future financial loss in personal injury claims and the use of discount rates are not unique to the United Kingdom. The rates used vary between countries and caution must be exercised in making comparisons where the underlying systems of providing compensation may actually be significantly different. Nonetheless, lessons may be learned. The Ministry of Justice has therefore instructed the British Institute of International and Comparative Law to compare a number of systems internationally during the consultation period. The findings will be taken into account in considering whether reform is necessary. The research will focus on the following jurisdictions: Australia, Canada, France, Germany, Ireland, Hong Kong and Spain. This coverage should ensure the representation of common and civil law jurisdictions, a diverse geographical spread and a range of approaches and rates. Procedures include the setting of the rate through statutory provision (for example, in various Canadian Provinces and Australian States) or by the courts based on actuarial experts (for example, Hong Kong).

20. The expert panel which reported in 2015 noted the systems in Ontario and Hong Kong as examples of places where differential rates applied.

21. The panel reported that Ontario had two prescribed rates: one of 2.5% for future losses over more than 15 years and one for losses over shorter periods based on real return (this rate was 0% in 2012; minus 0.5% in 2013 and 0.3% in 2015); and that the courts in Hong Kong have adopted a different approach, but still acknowledging the presence of a 'term structure' for discount rates with the discount rate being minus 0.5% for terms of loss not exceeding 5 years, 1% for terms not exceeding 10 years and 2.5% for terms exceeding 10 years (2015 figures).

---

[13] https://consult.justice.gov.uk/digital-communications/discount-rate/results/discount-rate-report.pdf para 2.11

[14] Ibid para 1.22

[15] Ibid 4.22 – 50% corporate bonds, 30% overseas developed country government inflation linked bonds. And 20% in equities.

[16] Ibid para 6.9 – 6.14,

What should determine how the rate is set?

22. We now consider how the discount rate should be set. To do this we summarise the principles on which the rate is set at present and the principal criticisms that have been made. We then invite evidence to help us analyse the effect of the present law and any changes. To help inform the consideration of the issues we describe a set of principles on which the rate might be set in the future, with particular reference to the type of investments that might be considered as a basis for setting the rate or rates and the effect (if any) on the rate that ought to be attributed to the availability of PPOs. Finally, we consider how the rate or rates should be derived from the information available about the returns of the appropriate investments.

The present law on the setting of the discount rate

23. The key overriding principles for the setting of the discount rate under the present law are that the lump sum awarded for future pecuniary loss should:
    - fully compensate the claimant (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;
    - be set on the basis that personal injury claimants are to be treated as very risk averse and will invest cautiously.

24. These principles lead to the rate being set by reference to the returns on very low risk investments such as ILGS yields. Using ILGS as the benchmark for setting the discount rate, which effectively assumes all claimants adopt a virtually risk-free investment strategy, minimises the risk that claimants will be undercompensated for their future losses by setting the discount rate at the lowest level possible. Where claimants adopt a different investment strategy with the potential to outperform the risk free rate, they have the potential to place themselves in a better financial position than had the incident not occurred. In practice claimants will pursue a range of investment strategies, but if on average they adopt a higher risk profile than ILGS and as a consequence have the potential for higher returns, then on aggregate the current law is at risk of overcompensating claimants. A different balance could be struck by altering the underlying assumption that claimants adopt a degree of investment risk. By reducing or eliminating the potential for overcompensation, this could achieve a fairer balance between claimants and defendants on aggregate. The degree of investment risk would need to be calibrated appropriately so that claimants are not exposed to such unacceptably high risks that they are not able to meet their expenses over time.

25. The principles also imply that the effect of a change in the rate on defendants cannot influence the decision on what the rate should be other than to the extent that the resulting award should be full compensation not more and not less. The discount rate should therefore produce an award that is fair between claimant and

defendant in providing 100% compensation, neither more nor less, for the wrongful injury. This paper is about how best to achieve this objective.

26. The recent change in the rate is expected to increase significantly the cost of lump sum awards of damages in personal injury cases. These additional costs are likely to be borne ultimately by consumers and taxpayers. This has raised the question whether the increased awards will over-compensate all or too many claimants and whether the basis on which the rate is set should be changed.

Criticisms of the law

27. Defendant interests have criticised the outcome of the recent review. Their principal criticisms are:
    - The present system of assuming a very low risk investment approach systematically over-compensates claimants because they are not, as a class, as risk averse as is assumed in the setting of the rate.
    - By setting the rate by reference to "risk free" investments the present law protects the most vulnerable claimants (who would, given their absolute dependency on the award, rationally take a very risk averse approach to investment). This has the result that other less vulnerable claimants are potentially over-compensated relative to their actual investment risk appetite, because they will earn a higher return (at the expense of the defendant).
    - Claimants do not in practice invest only (or even largely) in ILGS. The assumption that they do so is unrealistic and the rate should be set on the basis of the way that they do invest or are advised to invest. Indeed, the argument is also made that assuming 100% investment in any single type of investment might itself increase risk due to lack of diversity.
    - Returns on ILGS are not an appropriate reference rate for the setting of the discount rate because the market in ILGS is distorted by special factors that do not apply to investments by personal injury claimants.
    - Any system that produces a real negative rate must be flawed on the basis that it would be irrational to pursue an investment strategy with certainty of loss.

28. There are counter-arguments to some of these criticisms. The discount rate is applied to try to produce full compensation, neither more nor less, over potentially very extended periods into the future. There are bound to be some cases where the award is more than sufficient and some where it is insufficient. In reality, claimants face investment risks and some may not be well placed to deal with shortfalls and on this basis it is reasonable for the system to protect claimants. Negative rates are simply a product of market conditions and there is no reason to isolate the discount rate from the market.

Q1: Do you consider that the present law on setting the discount rate is defective? If so, please give reasons.

Evidence

29. In applying the principle of 100% compensation we do not know whether or to what extent the class of personal injury claimants in receipt of awards to which the discount rate is applied is homogenous or varied. All are likely to be seriously injured

individuals but their injuries, needs and circumstances will differ. Some may be totally dependent on the award, others may not. Some who are totally dependent on the award may adopt different investment strategies from other claimants. We do not know to what extent the most vulnerable claimants (that is those most dependent on their awards) adopt the most cautious investment policies. We also do not know whether or to what extent claimants currently taking a lump sum might be better protected taking a PPO; or if so whether those claimants would actually be offered a PPO or take it up if it was offered.

30. As there is very little robust empirical evidence as to how claimants invest their awards, it is difficult to judge properly whether the present assumptions made in setting the rate are significantly out of kilter with actual claimant behaviours. This problem is compounded by the difficulty of observing comprehensively the risk appetite of all claimants. We are therefore using this consultation paper to seek evidence about how claimants and defendants – and their advisers - actually behave before and after the award of damages is made. We are particularly interested in whether investments are in ILGS only or mixed portfolios and if the latter what they comprise and how they are managed; whether and how investments are diversified to minimise risk; and what advice claimants receive as to expected rates of return and risks.

Q2: Please provide evidence as to how the application of the discount rate creates under or over-compensation and the reasons it does so.

Q3: Please provide evidence as to how during settlement negotiations claimants are advised to invest lump sum awards of damages and the reasons for doing so.

Q4: Please provide evidence of how claimants actually invest their compensation and their reasons for doing so.

Q5: Are claimants or other investors routinely advised to invest 100% of their capital in ILGS or any other asset class? Please explain your answer. What risks would this strategy involve and could these be addressed by pursuing a more diverse investment strategy?

Q6: Are there cases where PPOs are not and could not be made available? Are there cases where a PPO could be available but a PPO is offered and refused or sought and refused? Please provide evidence of the reasons for this and the cases when this occurs.

Q7: Please provide evidence as to the reasons why claimants choose either a lump sum or a PPO, including where both a lump sum and a PPO are included in a settlement.

Q8: How has the number of PPOs changed over time? What has driven this? What types of claims are most likely to settle via a PPO?

Options

31. No decisions have been taken as to whether there is a better and fairer alternative approach to the setting of the discount rate. Any changes to the law will be decided in the light of all the evidence available following the close of the consultation, but it

is not necessary to wait for further evidence to become available before inviting views on the principles and methodology for the setting of the discount rate.

32. Our starting point is that the discount rate is used as part of a calculation which converts a future stream of income into a present lump sum. The lump sum payable should, in accordance with the general law of damages, represent the full loss, neither more nor less, caused by the wrongful injury. This principle should strike an appropriate balance between the legitimate interests of claimants and defendants. Setting an appropriate discount rate that reflects the 100% compensation rule is itself the protection against over-burdening consumers and taxpayers who ultimately have to fund many of the awards made for wrongfully inflicted personal injuries.

33. The current law also assumes that the discount rate should be set with the principle in mind that claimants should be assumed to need to meet all their losses as they fall due without shortfall and on time; and that the award should be exhausted (both capital and income earned on it) at the end of the period for which it is awarded.

Principles

34. We do not know what the outcome of the consultation and the consideration of the evidence will be but it may be helpful to outline the principles that might be used to set the discount rate for comments.

35. The setting of the rate will depend critically on the returns to be expected from the investments assumed to be made. This consultation will help inform what the characteristics of those investments should be. For example, the claimant assumed to exist for the purposes of setting the rate might be characterised as a very low risk investor (as under *Wells v Wells*) a low risk investor (who would have a slightly higher investment risk profile), an ordinary prudent investor (who would have a higher investment risk profile) or some other kind of investor.

36. The general principles for setting the rate might be as follows:

    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 (see below) 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;
    - 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.

    Due regard should be given for the following factors:

    - actual returns that claimants are likely to receive on investments; and
    - availability of a PPO in respect of some or all of the loss.

37. The appropriate risk profile would define the assumed returns and risks that claimants would be assumed to receive and take respectively. The choice of what those should be would be made in the light of evidence of the investments that claimants actually make and those they are advised to make, so that the discount

rate would reflect investments that are or ought to be made by claimants with the appropriate risk profile. In making these decisions consideration would also be given to the volatility of investment returns as not all losses and costs may always be met on time. The claimant should for these purposes also be assumed to be properly advised.

38. These principles provide a general framework but more is needed to provide the basis for setting the rate both as to the nature of the claimant investor and the precise methodology to be applied in the calculation of the rate. In the following paragraphs we consider the issues relating to defining the appropriate risk profile.

39. The present law assumes in the light of these principles that the claimant should be considered to be a very risk averse investor. The discount rate therefore reflects the returns that are to be expected from very safe investments, which will tend to be correspondingly low return investments. This assumption was not derived from and was not intended to reflect actual claimant investment behaviour. It might therefore be asked whether the assumption should be based on returns that claimants are likely to receive on their investments.

40. We do not know how claimants actually invest or why they choose the investments they make, but it is clear from the text box below that the differences in returns from different investment approaches to risk are potentially very significant. These examples are derived from the work of the expert panel appointed in 2015. In relation to the ‘best risk’ elements in the portfolio mixes, the figures are based on historical returns, and hence are not necessarily a reliable predictor of future investment performance. They do, however, provide an indication of relative risk between the various portfolios considered. Moreover, the various constituents and weightings included in the ‘best risk’ portfolio are also not fixed (i.e. they may change over time, and are subjective). The figures therefore only provide an illustration of what the expert panel considered at the time to be the risks of the portfolio, and in any event date from 2015. There may be many other combinations of investments that might be considered in applying an assumption as to the returns that a claimant might reasonably be expected to take and the investment risks (and in particular that the money needed would not be available when required) that he or she would have to accept in doing so.

The options considered by the expert panel in 2015

The panel carried out actuarial and financial economics analyses of the investments that should be used to set a discount rate. In the financial economics analysis, a ‘best risk’ portfolio of assets was constructed, by selecting an appropriately weighted combination of different asset classes which, in aggregate, provide for a very low risk investment portfolio. This ‘best risk’ portfolio comprised 50% UK Corporate Bonds, 30% World government inflation-linked bonds, and 20% World Equities. The panel considered that this portfolio alone was (with reference to the present law) too risky for a typical claimant, but by combining different proportions of the ‘best risk’ and ‘risk free’ (100% ILGS) portfolios, could provide for a suitable overall portfolio: “The panel is in complete agreement that, if forced to accept some investment risk, then the second portfolio (three-quarters ILGS and one-quarter in an optimal mix of risky investments) is potentially appropriate for a very low risk, but not a ‘risk free’, investor and the 100% rule [principle]”.

As part of this analysis, various metrics were used to determine the risk/reward profile of this resulting portfolio (75% ILGS, 25% 'best risk' portfolio). The principal inflation-adjusted metrics used for various combinations of the 'risk free' and 'best risk' portfolios are summarised below.

Standard deviation provides a measure of the expected volatility for the various portfolio mixes. It provides an indication of how frequently the returns are expected to fall within a range of actual RPI. In the 75% / 25% mix that was identified by the expert panel as potentially appropriate for a very low risk investor, a standard deviation of 1.25% equates roughly to investment returns being expected to be in the range:

+/-1.25% from RPI in two of every three years considered

+/-2.50% from RPI in 19 of every 20 years considered (equivalently it is expected to fall outside this range in 1 of every 20 years considered).

These portfolios show that the injured person is being assumed to accept a material increase in risk in the calculation of the discount rate and that this will potentially affect the investment policy that the claimant would have to pursue in the real world to match the expected losses as they occur.

Combinations of 'risk free' and 'best risk' portfolios

	Percentage of 'risk free' / 'best risk' portfolio			
Metric (*)	100% / 0%	**75% / 25%**	50% / 50%	0% / 100%
Annual average real return	-1.0% (*)	**-0.125%**	0.75%	2.5%
Standard deviation of real returns	0%	**1.25%**	2.5%	5.0%

NOTE (*) The real return used for the 'risk free' portfolio was based on typical ILGS yields available at the time when the expert panel report was produced. This contrasts with returns used for the 'best risk' portfolio, which are based on considering how this portfolio would have performed over the 15-year period from 1st January 1999 to the end of December 2014. Real returns are adjusted to factor in typical transaction costs, management costs and an allowance for tax.

41. A mixed portfolio approach would not be unprecedented. In its decision in *Wells v Wells*, which was overturned by the House of Lords, the Court of Appeal had concluded that for the purpose of setting the discount rate the claimant was in no different position from the ordinary investor and that treating the claimant as being in some different category would be to place him or her unwarrantably in a privileged position.

42. The Court of Appeal thought that the role of the court was to hold the balance evenly between both sides, so that the claimant got an award as near as possible to full compensation but the defendant benefited from the presumption that the claimant would adopt a prudent investment policy. In considering what would be a prudent investment policy the Court of Appeal accepted that equities were more risk-prone than ILGS but did not consider that ILGS were risk free. In the opinion of the Court of Appeal the flexibility of equities as an investment was attractive as against the relative rigidity of ILGS if the estimate of the claimant's future losses and needs turned out to be inaccurate. The Court of Appeal considered that prudent investment required the choice of a basket of investments. Such baskets may come in many shapes and sizes.

43. There are of course other riskier portfolios, but the chances of creating too much uncertainty as to whether payments could be made when they were needed from the award might be thought to militate against assuming claimants should seek very high returns.

44. There is therefore a case that even though there will be an increased risk for the claimant, a mixed portfolio of investments, suitably constructed possibly by reference to investments that claimants actually make and the returns to be expected from them, would produce a package that would potentially be suitable for the purpose of setting the rate. On this basis, the rate would be set by reference to an appropriate mixed portfolio prepared and managed by professional investment advisers. This could lead to a system that more closely reflected actual behaviours and produced a higher discount rate.

45. Clearly, the return or risk deemed to be appropriate would have to be defined with sufficient clarity to be workable and predictable. It may be that some degree of tolerance for over- or under-achievement would have to be built into the definition so that the appropriate investments could be identified and, if necessary, balanced against one another to produce an investment package that is in overall terms fair. Whether one type of claimant should have a greater weighting than another would have to be decided.

46. Whatever the portfolio adopted as the basis for setting the rate, the claimant should be assumed to be properly advised. We understand that most if not all recipients of significant awards of damages will receive expert financial advice.

Relationship of the lump sum award and periodical payment orders

47. At present, the possibility that the damages might be awarded by means of a PPO does not affect the setting of the discount rate. The court can order a PPO in any case notwithstanding the wishes of the parties and claimants could in principle argue for a PPO if they are genuinely concerned about their ability to invest their lump sum successfully enough to meet the rate of return implied by the discount rate. If the basis of the setting of the discount rate were to be changed so that the rate is to be set by reference to riskier investments than at present, the ability of a claimant who has a lower risk profile than that assumed for the purposes of setting the rate to take a periodical payment could be a way for claimants to avoid the additional risk.

48. In relation to all awards of lump sums for future pecuniary loss, however, the argument has been made by defendants that the claimant had the option of taking a

periodical payment order, which would pass many of the risks to the defendant. The implication is that the claimants, having passed up a risk-free PPO, cannot be as risk averse as is assumed in the present law on the setting of the discount rate.

49. If PPOs are offered and claimants do reject them in favour of a lump sum, there would be a strong case for saying that the offer of the PPO should have an effect on the discount rate, but the very availability of a PPO in principle as a means of receiving risk free compensation might itself mean the discount rate should be affected.

50. If this were to happen there would be a question as to how the effect would be calibrated. How much of an increase in risk appetite would be deemed to apply and what would happen in cases where no PPO had realistically been practicable?

51. The degree of increase could be difficult to assess but the general principle would be an additional factor in support of assuming a higher risk profile. For those cases where a PPO is not practicable one approach might be to leave the court to exercise its discretion to apply a different rate.

Q9: Do claimants receive investment advice about lump sums, PPOs and combinations of the two? If so, is the advice adequate? If not, how do you think the situation could be improved? Please provide evidence in support of your views.

Q10: Do you consider that the present law on how the discount rate is set should be changed? If so, please say how and give reasons.

Q11: If you think the law should be changed, do you agree with the suggested principles for setting the rate and that they will lead to full compensation (not under or over compensation)? Please give reasons.

Q12: Do you consider that for the purposes of setting the discount rate the assumed investment risk profile of the claimant should be assumed to be:

(a) Very risk averse or "risk free" (Wells v Wells)

(b) Low risk (a mixed portfolio balancing low risk investments).

(c) An ordinary prudent investor

(d) Other.

Please give reasons.

Q13: Should the availability of Periodical Payment Orders affect the discount rate? If so, please give reasons. In particular:

- **Should refusal to take a PPO be taken as grounds for assuming a higher risk appetite? If so, how big a difference should this make to the discount rate?**
- **Should this assumption apply in cases where a secure PPO is not available?**

Q14: Do you agree that the discount rate should be set on the basis that claimants who opt for a lump sum over a PPO should be assumed to be willing to take some risk? If so, how much risk do you think the claimant should be deemed to have accepted? Please also indicate if you consider that any such assumption should apply even if a secure PPO is not available. Please give reasons.

More than one discount rate?

52. Section 1 of the Damages Act 1996 provides for different rates to be set for different types of cases and for the court to depart from the prescribed rate in appropriate cases. To date only one rate has been set by the Lord Chancellor and her counterparts in Scotland and taken into account by the courts. There are clearly practical advantages in this simple approach. On the other hand, setting more than one rate means that different degrees of investment risk may be assumed in relation to different parts of the award, which may reduce the difference between the risk appetites assumed in the setting of the rates and the actual risk appetites of claimants.

53. Consideration could be given to specifying different rates for different types of cases, perhaps by reference to the length of awards, their size or by reference to the identity of the claimant or defendant: for example, claimants with particular injuries or needs, or a public sector body as opposed to a private sector one. In relation to differentiating rates on the basis of the length of the award, we note that Ontario operates a system of this kind in which awards either side of a 15 year threshold have very different rates. Such a system may, however, lead to a certain amount of gaming the system.

54. Different rates might be set for different parts of awards (e.g. cost of care and loss of earnings) on the basis that greater risk might reasonably be expected to be taken in relation to loss of earnings which may be thought to be always at risk for people generally, who may be affected by redundancy or insolvency, whereas money for care costs can reasonably be expected to be carefully protected as an essential safety net. However, we do not consider that the discount rate can operate at different levels based on the availability of other resources to meet the losses as they fall due. To do so would be contrary to the principled application of the law, which applies to rich and poor alike, and would result in the claimant paying the costs of the injury.

55. The setting of different rates for different cases could potentially lead to greater fairness as different rates would presumably be more likely to match the real circumstances of individual cases. It would, however, also lead to greater complexity. There was not much support for the idea from the responses to the earlier consultations nor was the expert panel much attracted by the idea of different rates by reference to duration of the award. They concluded that: “On the assumption that the discount rate continues to be set by consideration of ILGS yields then there is some justification for using a modestly higher discount rate that might be obtained solely by inspection of yields available up to 50 years in duration. The impact of any allowance however seems likely to be modest and we would therefore support use of a discount rate which does not vary by the duration of loss.” In relation to the possibility of using a mixture of ILGS and an optimally constructed portfolio of ‘risky’ investments the panel considered that the “concept of a term structure for discount rates does not extend naturally to non-risk free investments but some consideration might conceivably be given to valuation frameworks incorporating risk free discount rates, of say -1%, at short and medium duration with ‘mixed portfolio’ discount rates of, say 0% or 0.5%, at the longest durations.”

56. Section 1 of the 1996 Act also permits the court to apply a different rate if it is persuaded by one of the parties that it would be more appropriate to do so. It seems this power has been very rarely exercised. One possibility is that the court might be

encouraged to use the power where there is a long term seriously injured claimant who is reliant on the award and no PPO can be offered. This could offer greater fairness. On the other hand, widening the possibility of different rates could generate additional legal argument, increasing costs and causing delay.

57. If a power to depart from the specified rate is preserved the question arises whether the power should be as tightly confined as the present power has been interpreted as being (see *Warriner v Warriner*).

Q15: Do you consider that different rates should be set for different cases? Please give reasons. If so please indicate the categories that you think should be created.

Q16: Please also indicate in relation to the categories you have chosen whether there are any special factors that should be taken into account in setting the rate for that category.

Q17: Should the court retain a power to apply a different rate from the specified rate if persuaded by one of the parties that it would be more appropriate to do so? Please give reasons.

Q18: If the court should have power to apply a different rate, what principles should apply to its exercise?

Methodology for setting the discount rate – averages, tax, investment costs, rounding

58. The setting of overall principles to guide the assessment of the appropriate discount rate will not of itself be sufficient to direct a setter of the rate to a precise figure. More detailed calculations will have to be made. Thus, in addition to setting out what the relevant portfolio of investments is to be assumed to be, the principles might have to provide sufficient guidance on the important technical questions as to how the rate should be calculated from the information available about the returns. Alternatively, these matters could be left, with or without guidance, to the rate setter to decide.

59. The kind of issues that will have to be considered are illustrated by the Lord Chancellor's statement of reasons for her decision to lower the discount rate. The Lord Chancellor said:

> "To weight long term stocks in a simple and transparent way, I have taken a simple average of gross real redemption yields across all ILGS and, in line with Wells v Wells, have excluded stocks with less than five years to maturity. This is not to deny the need for some or, indeed, all claimants to receive an income in the first few years of their award but to account, in a simple way, for the effect that short-dated stocks can have on real redemption yield as a representative discount rate for claimants as a whole. The real yield data on which I have obtained an average are those published by the Debt Management Office (DMO).
>
> Regarding the period over which the real redemption yield is averaged, I have followed the majority view from Wells v Wells and the practice adopted by Lord Irvine in 2001, namely to average over the three years to a convenient date (in this instance, 30 December, the last trading day of 2016). I note that real yields have witnessed steady decline since 2001 and there may be a case for changing

the averaging period to limit the influence of historical trends. However, I am reluctant to depart from earlier practice on this occasion.

The three year simple average gross real redemption yield on ILGS is minus 0.83% as of 30 December 2016 excluding ILGS with less than 5 years to maturity. As noted above, it would be appropriate to round this figure to acknowledge the inherent uncertainties and imprecisions involved in setting a representative discount rate and I am persuaded that rounding to the nearest 0.25% point is adequate. This would lead to a discount rate of minus 0.75%. The only reason to round down to minus 1.00% would be to account for claimant costs, in particular taxation and management fees. However, the case for such adjustment is not strong and has weakened in recent years. Because of the steady issuance of new ILGS with lower coupons (and, therefore lower taxation), it is not unreasonable that an adjustment for tax should be lower now than when Lord Irvine determined the discount rate in 2001; and investment management costs are relatively modest for ILGS."

60. Special rules might be made about all, any or none of these matters. Investment costs in particular would be a more important consideration if a mixed portfolio approach was to be adopted – as would taxation if returns are expected to be higher. The degree of discretion as to the "rounding" permitted could also be left at large or controlled. Tax and investment costs would in practice vary between investors, so a decision will be needed as to how they might best be allowed for.

61. A further specific possibility for consideration is that the rate might be set on a split basis. There could, as is found in insolvency legislation, be a "risk free" rate and a "risk premium" rate, the sum of which would be the total rate. The risk premium rate would be expected to be fairly static but the risk free rate would be changed regularly following movements in the prices of risk free investments. This approach might help make clearer the working of the rate.

Q19: Do you consider that there are any specific points of methodology that should be mandatory? Please give details and reasons for your choice.

When should the rate be set?

62. Under section 1 of the Damages Act 1996, the Lord Chancellor and her counterparts in Scotland set the rate from time to time. Their duty is to ensure that the rate set is appropriate in accordance with the legal principles governing the setting of the rate. This gives flexibility for the rate to be changed when a change is necessary but there is no guarantee as to how frequently or when reviews will occur, which means that the discount rate may not necessarily reflect the prevailing yields on ILGS at all times.

63. The primary question is therefore how often should the discount rate be reviewed? Should the answer be (as now) from time to time so that there is no set pattern? Or should some degree of regularity be imposed (and if so what) and should it be displaceable in any circumstances?

64. The absence of a completed review between 2001 and 2017 and the recent reaction to the rate change suggests that there may be benefit to claimants and defendants in a more structured approach. A structured pattern of review would also make it easier for the decision makers setting the rate by providing a clear framework in which their work has to be carried out; and for those affected by changes in the rate to anticipate when changes might occur.

Options

65. The discount rate should ideally always be accurate by reference to the returns on the investments by reference to which the rate is to be set. In principle, subject to avoiding over-frequent changes, it should therefore be reviewed as often as is necessary to reflect material changes in returns from those investments.

66. It would be possible to change the law so that the timing of changes in the rate, or at least reviews of whether the rate should change, could be known in advance. This could be combined with allowing the rate to be changed at appropriate times as at present, with the specified review points operating as a longstop.

67. Options could include introducing specific minimum review periods, linking reviews to movements in indices of yields of whichever investments are chosen as a benchmark for the rate (such as, if the rate is set by reference to ILGS, material changes in ILGS redemption yields, and the issue of CPI-linked stocks), or some combination of the two. A further more fundamental alternative, which is not possible under the present law, would be to link the rate to a formula and to provide for it to adjust automatically, either continuously or at specified intervals: for example, by reference to returns on a single type of investment or a mixed portfolio of specified investments. The latter would be a good deal more complicated to maintain. Continuous adjustment would largely remove the need for intermittent reviews, but at the cost of some complexity.

68. The obvious model would include a review at the end of a set period – for example, every one, three, five or even 10 years. The length of this period could be influenced by the period over which the statistics to be used in the setting of the rate are to be averaged. A longer averaging period would mean that more frequent reviews would

be likely to produce smaller changes. The choice of the review period and the averaging period are, however, separate.

69. A fixed pattern of review could be combined with a review triggered by a particular percentage change in the yields of the investments by reference to which the rate is set. This might be tempered by a requirement that change be sustained for a specified period. Expectations of the volatility of returns from the relevant investments might also be a factor in deciding the length of periods of review. Under this model the date of the review could be fixed in legislation. Consideration would have to be given to the best time of year for the new rate to come into force.

70. Creating this second tier trigger for review could be argued to justify a longer review period, as the rate could then be adjusted within the period if there were material changes in yields. To create a second trigger of this kind it would be necessary to have a suitable measure to use as an index. Clearly, the more complex the mix of investments used to set the rate (see below) the more difficult it may be to create the index by reference to which changes in investment returns can be compared over time. So, for simplicity, the trigger might be set by reference to changes in a single representative index or rate. A review on a trigger point could reset the time period cycle so that over-frequent reviews were avoided.

71. It might even be useful to put in place a further override, under which the time and trigger cycles themselves can be reviewed. This might be a useful safeguard if the investment by reference to which the rate was being set disappeared or fundamentally changed its characteristics – or indeed if it was no longer the best point of reference because a new investment product has emerged.

72. Setting a cycle and pattern of review times would clearly help increase the regularity and predictability of a review. It would, however, not be entirely neutral in its effect. The approach of a review could have an effect on the behaviour of litigants as expectations as to the direction and magnitude of a change could lead to parties seeking to hasten or delay the conduct of the litigation. The nature of the effect on behaviour might be related to the likely size of the prospective change in the rate. Retaining the ability to change the rate at appropriate points would counter the risk of intervals that turned out to be overlong.

73. Any review of the rate under these various circumstances would have to be clearly documented and the reasons for the outcome explained.

74. If a variety of different rates are set then the same review principles would apply to each rate set – albeit the triggers may be different as regards the percentage change, as different rates could be set by reference to different investments. Similarly if there is one rate comprising different elements, such as on the risk premium basis (see para 61).

75. The review triggers could be specified in primary legislation and only changeable by Act of Parliament. Alternatively, a power might be created to enable them to be changed from time to time. This would create a flexibility to meet changing circumstances more easily.

76. Another matter to consider is whether the new rate set under the new procedure should apply to all cases coming before the court on or after the date the new rate comes into force or whether there should be provision for transitional provisions so

that, for example, the rate might only affect new causes of action or new proceedings.

Q20: Do you agree that the law should be changed so that the discount rate has to be reviewed on occasions specified in legislation rather than leaving the timing of the review to the rate setter? If not, please give reasons.

Q21: Should those occasions be fixed or minimum periods of time? If so, should the fixed or minimum periods be one, three, five, ten or other (please specify) year periods? Please give reasons.

Q22: When in the year do you think the review should take effect? Please give reasons.

Q23: Do you agree that the rate should be reviewed at intervals determined by the movement of relevant investment returns? If so, should this be in addition to timed intervals or instead of them? What do you think the degree of deviation should trigger the review?

Q24: Do you agree that there should be a power to set new triggers for when the rate should be reviewed? If not, please give reasons.

Q25: Do you consider that there should be transitional provisions when a new rate is commenced? If so, please specify what they should be and give reasons.

Who should set the rate?

77. At the moment, the rate is set by the Lord Chancellor, who before changing the rate is obliged to consult the Treasury and the Government Actuary. Scottish Ministers are obliged to consult the Government Actuary. The Lord Chancellor and her counterparts are required to set the rate using the same approach as the courts would have done had they continued to set the rate.

78. Since 1996, there have been significant changes in relation to the role of the Lord Chancellor. In 1996 the Lord Chancellor was the Head of the Judiciary and actively participated in hearing cases as a member of the Judicial Committee of the House of Lords. Now the judiciary is led by the Lord Chief Justice and the Lord Chancellor is a member of the House of Commons with no judicial role and need no longer be a lawyer. At present, the Lord Chancellor is also the Justice Secretary, a leading member of the Cabinet in charge of a major government department, including the Prison and Probation Service, whose finances, like the finances of several other government departments, will to varying degrees be affected by changes in the rate.

79. Ministers are expected in various circumstances to be able to take decisions independently of the interests of government. The present system could therefore continue, but this should not preclude consideration of the possibility of giving the task of setting the discount rate, within principles clearly defined by Parliament, to an independent expert body given the technical nature of the exercise and, under the present law, the limited extent of the Lord Chancellor's discretion to act (because she has to comply with the legal principles applicable to the setting of the rate).

80. There is accordingly a case for considering the decision on what the rate should be as something better left to expert advisers independent of government, or even to be adjusted automatically in accordance with a pre-set formula. Scottish Ministers are also interested in views on this issue.

Options

81. There are several options.

82. First, a panel of experts could be appointed to set the rate in accordance with the relevant principles and methodology. The panel would create a simple unified structure for expert consideration and decision making. The process of decision making should become more open and transparent.

83. The panel might be specially established or might build upon an existing body such as the Ogden Committee which, with the support of the Government Actuary's Department, is responsible for producing the Ogden Tables used to apply the discount rate in individual cases.

84. The panel would clearly need professional and technical expertise. It could be made up of appropriate experts: actuaries, financial experts, investment advisers, and economists selected or nominated for the purpose. Five members including an independent chair, perhaps the Government Actuary, might be an appropriate number.

85. The panel should be required to consult with interested parties, such as representative bodies of claimants, insurers, lawyers, consumers and other interested parties, some or all of whom might be specified in the legislation. The panel could be empowered to take evidence and carry out research as necessary. It could also be required to consult specified persons or organisations before reaching a decision.

86. The power to make appointments to the panel could be given to the Lord Chancellor, alone or in conjunction with another person, perhaps with the concurrence of another office holder. Appointments to the panel would need to comply with the Code of the Commissioner for Public Appointments and would need to be funded (including for the remuneration and reimbursement of panel members). It would also have to be decided whether appointments would debar members from sitting in Parliament.

87. The terms of reference and remit of a panel would be defined in the light of the principles for setting the rate and the frequency with which the appropriateness of the rate had to be considered (see above). The length of appointments to any panel would need to take into account the decision as to the frequency of the rate reviews and issues of security of tenure would have to be addressed. Clearly it would be unhelpful to have a panel change in its entirety as a review approached.

88. A panel would also be able to offer advice to the government from time to time on any need for changes to the principles which govern how the rate is set. This might be useful in any event but could be particularly so if specific investments are specified in the methodology for setting the rate as the panel would be well placed to ensure the investments chosen remained appropriate. Clearly, if this approach were to be adopted there would need to be a procedure by which changes could be made to the then existing framework.

89. Secondly, the rate might be set by the panel but subject to the agreement of another person, whether a Minister or not: such a person's power to resist the panel's proposal could take a variety of forms including an absolute right of veto, a power to determine when the new rate is to take effect, or simply a power to remit the decision for re-consideration. The correct balance may depend upon the degree of latitude permitted to the panel in the setting of the rate.

90. Thirdly, the rate might still be set by the Lord Chancellor and her counterparts in Scotland or another nominated person, but he or she could be required to consult with a standing advisory panel (such as that described) before making a decision. Again, the degree to which the decision maker could resist the advice received could vary in much the same way as if the panel were setting the rate subject to his or her agreement. This approach could require the decision maker to consult a wider range of opinion and expertise than the present statutory consultees.

91. If the rate were to be set by reference to a basic risk free rate and a risk premium rate different approaches could apply to each with the risk premium rate perhaps being reserved to a Minister and the basic risk free rate being set by a panel.

92. Whatever approach is adopted provision will need to be made for the promulgation of the rate. This might be by statutory instrument as at present or, for example, by a report laid before Parliament. If the rate were to be tracking an index then a website notification might suffice.

93. Clearly, the decision on whether to retain a ministerial role in the setting of the rate will be related to the scope of the powers to be conferred on the panel and the minister. This decision will probably depend upon the principles on which the rate has to be set and how closely defined they are in legislation, so that the wider the power of the panel the more necessary it might be to retain a degree of political control.

94. It would in the normal course of events take some time for the enactment of primary legislation to recruit and appoint a panel and for the panel to come to a decision on what the rate should be. This might be shortened by establishing the board on a shadow basis so that delay is avoided. An alternative would be to apply a different procedure to the first setting of the rate following the enactment.

Q26: Do you consider that the discount rate should be set by:

- **a) A panel of independent experts? If so, please indicate how the panel should be made up.**
- **b) A panel of independent experts subject to agreement of another person? If so, on what terms and whom?**

  Would your answers to the questions above about a panel differ depending on the extent of the discretion given to the panel? If so, please give details
- **c) The Lord Chancellor and her counterparts in Scotland or another nominated person following advice from an independent expert panel? If so, on what terms?**
- **d) The Lord Chancellor and her counterparts in Scotland as at present?**
- **e) Someone else? If so, please give details.**

Periodical Payment Orders

95. In this section of the paper we consider whether sufficient use is being made of PPOs and whether an increase in their use might resolve some of the problems that arise from the use of lump sum payments. This part of the paper is therefore only indirectly concerned with the discount rate. Whilst the legal framework in relation to periodical payment orders is different in Scotland, Scottish Ministers are interested in views.

What are PPOs?

96. PPOs are essentially guaranteed annuities planned to meet the whole or a proportion of the expected future costs and losses caused by the wrongful injury. They are often combined with a lump sum payment. The relevant background is summarised in the following text box.

Periodical Payment Orders

Traditionally, damages had to be paid in a once and for all lump sum. This approach was modified by the emergence of structured settlements in the 1990s and then changed when section 2 of the Damages Act 1996 allowed the court to award periodical payments with the consent of the parties. This power was initially little used, but the law was then further amended with effect from April 2005 so that the court could make periodical payment orders without the consent of the parties. This led to an increase in use but the use of periodical payments only "took off" when the court adopted ASHE 6115 (a survey of earnings) rather than the Retail Price Index in 2008.

Periodical payments orders can take a number of forms. They can be variable in very limited circumstances: that is the amounts payable can be reassessed in the light of a significant deterioration or improvement in the claimant's condition, if the original order permits this. Very few of these variable orders are thought to be made. Stepped orders, where the amount payable from time to time varies in accordance with the order as originally made, are more common (for example, where it is predicted that additional or reduced care will be required at certain times). The most common form of periodical payment orders are orders where the payments can simply be index-linked to a variety of indices, including, for example, the Retail Price Index and ASHE 6115.

Why are PPOs used?

97. PPOs remove the need to make any discount in the award of damages and are tax free in the hands of the claimant. The money expected to be needed is paid by instalments when it is expected to be needed rather than in advance so that there is no question about whether the investment of the lump sum will produce enough income for the claimant. This is not to say that the payments are guaranteed to meet the actual expenses incurred by the claimant during the period of the award. The price of the actual services needed might, for example, have inflated faster than the index to which the PPO payment is linked. Life-time periodical payments will, however, pass longevity risk to the defendant, who will have to fund securely the payments to be made.

Who uses PPOs?

98. Claimants and defendants are thought to consider the choice between a PPO and a lump sum at an early stage of their negotiations and to varying degrees to keep the choice in mind as negotiations progress. Some will positively favour a PPO but some will not. Claimants may have personal reasons such as a desire to take control of the money and to make a clean break from the defendant. Defendants may wish to close off their liabilities. Both will be affected by the general economic climate. The NHS Litigation Authority ("NHSLA"), for example, has currently more than 50% of the total PPOs issued and generally obtains the claimant's agreement to a PPO when it wishes to do so. The costs of these awards are met from funds provided by contributions to the indemnity scheme by NHS provider members, who are ultimately funded from taxation. The other principal defendant using PPOs is the Motor Insurance Bureau (MIB). MIB was established in 1946 to compensate the victims of negligent uninsured and untraced motorists. Every insurer underwriting compulsory motor insurance is obliged, by virtue of the Road Traffic Act 1988, to be a member of MIB and to contribute to its funding. Private sector providers of PPOs, such as financial institutions, generally have to provide for future expenditure on PPOs in their accounts. This may have contributed to making PPOs less attractive to them than lump sum settlements overall.

When are PPOs awarded?

99. PPOs can be awarded by the court in all cases, irrespective of the wishes of the parties. It is not clear, however, that in practice the court awards a PPO against the wishes of the claimant.

100. PPOs can, however, only be made when the payer is considered sufficiently secure. PPOs against 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. PPOs ordered against the NHSLA and other taxpayer funded bodies are adequately secure as are those against the MIB, which is funded by a statutory levy on insurers.

101. Nonetheless, despite the security of PPOs made by regulated insurers, the use of PPOs is dominated by NHSLA and MIB. This suggests that both claimants and potential providers, such as financial institutions, find reason to prefer lump sum payments.

How many PPOs are made and how big are the awards made in this way?

102. In absolute terms the numbers of PPOs appear to be small, but they are used in a significant proportion of high value serious injury cases, particularly where the victim does not have capacity to manage his or her own financial affairs. We do not have comprehensive figures of PPOs being made but figures from the Institute and Faculty of Actuaries indicate that in the 200 or so large motor claims settled annually since 2009, 20% of claims in the £1m to £2m bracket settle by PPO but over 60% of claims in the £5m plus bracket do so.

Why are PPOs not used more often?

103. This consultation is not the first time that these issues have been considered. In the 2013 consultation paper[17] we examined whether there was a case for encouraging the use of PPOs and invited views on why they were not used more frequently and whether it would be appropriate to try to increase their use.

104. The overall response to this part of the consultation was inconclusive, but the majority of those who replied considered the present level of use was appropriate (61%) and that the parties were sufficiently informed about periodical payments (81%).

105. A variety of reasons were identified by respondents for the relatively low usage:

    - PPOs are not always appropriate: For example, in cases where there is contributory negligence or litigation risk, claimants need the flexibility to use their award for priority areas and need to invest to make up the shortfall; and the administration costs can be disproportionate.

    - Provider limitations: For example, policy limits may prevent the use of PPOs and not all potential providers are willing or able to provide long-term security; linking PPOs to ASHE 6115 makes it difficult for potential providers to purchase annuities to meet annual indexed payments; re-insurers discourage insurers from taking up PPOs; concerns about the capital requirements of PPOs; and potential providers benefit from the finality of a lump sum payment.

    - Claimant issues: for example, where a PPO is not offered, the Part 36 lump sum offer is accepted due to the costs consequences if a PPO is no better; capital is needed to make up the deficiencies in the approach in *Roberts v Johnstone*[18] to compensating claimants for necessary capital expenditure on accommodation; and the amount and timing of future costs, or the need to amend them, are difficult to predict in advance. More generally, claimants cannot spend flexibly with fixed payments and may have a desire to cut all links with the defendant.

106. In many cases both a PPO and a lump sum are awarded with the PPO being used in respect of future care and case management costs, with the balance between them being decided in negotiations. One respondent stated in general terms that PPOs are intended to be used for future loss of earning capacity as well as care costs, and seven respondents noted that periodical payments were used for future loss of earnings in very few cases.

What conclusions should be drawn?

107. PPOs have strong theoretical attractions if the principal objective is to ensure that the claimant receives money at the times and in the amounts predicted to be necessary in the court settlement. This is broadly speaking the driver behind the setting of the discount rate in the present law, but there are other factors relating to

---

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

[18] [1989] QB 878 CA

other aspects of the law that the parties will want to take into account, which militate against the use of PPOs.

108. Of course, all these comments were made in the context of the previous rate. It remains to be seen how the recent change in the rate will alter patterns of use. Certainly, there must be an expectation that the decrease in the rate will make lump sums larger and more attractive to claimants. Whether they will be sufficiently attractive to claimants as to overpower their present reasons for choosing PPOs, particularly in cases of life long serious injuries to a person without any independent mental capacity, will only become clear with time.

109. This possibility is clearly of concern to defendants, particularly the ones who use PPOs extensively. It also raises more general concerns that PPOs will become under-used and that this may place claimants (despite their best estimates or the best estimates made on their behalf at the time of the award) at greater risk of not being able to meet the expenses and costs that are expected to occur. This would seem to be an unsatisfactory outcome.

What might be done about this possible situation?

110. One response would be to wait and see. The 2013 consultation indicated a broad satisfaction with the balance between lump sums and PPOs so time should be allowed to pass before another judgement is made. However, delaying in this way could allow problems to develop that could be avoided by prompter action. This consultation paper provides an opportunity to seek views and evidence about the use of PPOs.

111. Another response would be to leave the decision as to whether a PPO should be made to the court. It has power to award a PPO under the present law and will do so where it is just to do so. It may however not be absolutely clear to the parties as to when the court might do this. It would be for consideration whether the circumstances in which this power might be exercised might be made clearer, perhaps by guidance or by rules of court. However, many cases are thought to settle by way of a consent order. It is unlikely in these cases that the court will overturn the settlement reached. A means may need to be found to influence the decisions made at an earlier state of the process.

112. These two approaches assume that attitudes do not change materially as a consequence of the change in the discount rate. However, defendants who use PPOs and to whom finding immediate cash to pay lump sums would be a major additional burden, might take the view that the change to the discount rate is so significant that some change is needed in relation to PPOs if the previous balance of the system is to be preserved. Possible changes include legislating to:

- Create a presumption that if a secure PPO is available it is the appropriate form of compensation for compensating future long term financial loss. The presumption could be created on terms that it is rebuttable. This could, perhaps, be on the basis that the claimant could show that the award of the PPO would cause him or her hardship or simply be less suitable for meeting his or her anticipated needs. Its application could be general or restricted to some particular types of loss, such as future cost of care. Long term would need to be defined but perhaps 15 years or more would be a suitable duration.

- Require the court to order a PPO if a secure PPO is available. This could be general or limited to specific kinds of loss and might be made subject to the condition that the defendant wished to provide compensation in this way. This latter provision may seem to favour the defendant unduly but if PPOs take away significant risks from the claimant and the object of the law is to provide full compensation neither more nor less, then the award would still serve the purpose of the law.

113. We would welcome views on these possibilities and any costs and benefits that they may create.

114. A potential problem with increasing the use of PPOs indiscriminately is the additional cost that this may impose on potential providers of PPOs if they remain a more expensive solution to a claim, as we understand they are for many providers on account of the reserve provision required in relation to the projected liabilities contained in the order. These additional costs would probably ultimately be borne by consumers and businesses through increased insurance premiums and taxation. We would welcome suggestions as to how the cost of PPOs to providers might reasonably be reduced.

115. To help us assess what change, if any, should be made we would welcome evidence as to the use or expected use of PPOs in the light of the change in the rate and more generally.

Q27: Do you consider that the current law relating to PPOs is satisfactory and does not require change? Please give reasons.

Q28: Do you consider that the current law relating to PPOs requires clarification as to when the court should award a PPO? If so, what clarification do you consider necessary and how would you promulgate it?

Q29: Do you consider that the current law relating to PPOs should be changed by creating a presumption that if a secure PPO is available it should be awarded by the court? If so, how should the presumption be applied and on what grounds could it be rebutted?

Q30: Do you consider that the current law relating to PPOs should be changed by requiring the court to order a PPO if a secure PPO is available? If so, what conditions should apply?

Q31: Do you consider that the cost of providing PPOs could be reduced? If so, how.

Q32: Please provide details of any costs and benefits that you anticipate would arise as a result of any of the approaches described above.

Q33: Please provide any evidence you may have as to the use or expected use of PPOs in the light of the change in the rate and more generally.

Questionnaire

We would welcome responses to the following questions set out in this consultation paper.

Q1: Do you consider that the law on setting the discount rate is defective? If so, please give reasons.

Q2: Please provide evidence as to how the application of the discount rate creates under- or over-compensation and the reasons it does so.

Q3: Please provide evidence as to how during settlement negotiations claimants are advised to invest lump sum awards of damages and the reasons for doing so.

Q4: Please provide evidence of how claimants actually invest their compensation and their reasons for doing so.

Q5: Are claimants or other investors routinely advised to invest 100% of their capital in ILGS or any other asset class? Please explain your answer. What risks would this strategy involve and could these be addressed by pursuing a more diverse investment strategy?

Q6: Are there cases where PPOs are not and could not be made available? Are there cases where a PPO could be available but a PPO is offered and refused or sought and refused? Please provide evidence of the reasons for this and the cases where this occurs.

Q7: Please provide evidence as to the reasons why claimants choose either a lump sum or a PPO, including where both a lump sum and a PPO are included in a settlement.

Q8: How has the number of PPOs changed over time? What has driven this? What types of claims are most likely to settle via a PPO?

Q9: Do claimants receive investment advice about lump sums, PPOs and combinations of the two? If so, is the advice adequate? If not, how do you think the situation could be improved? Please provide evidence in support of your views.

Q10: Do you consider that the present law on how the discount rate is set should be changed? If so, please say how and give reasons.

Q11: If you think the law should be changed, do you agree with the suggested principles for setting the rate and that they will lead to full compensation (not under or over compensation)? Please give reasons.

Q12: Do you consider that for the purposes of setting the discount rate the assumed investment risk profile of the claimant should be assumed to be:

(a) Very risk averse or “risk free” (Wells v Wells)

(b) Low risk (a mixed portfolio balancing low risk investments).

(c) An ordinary prudent investor

(d) Other.

Please give reasons.

Q13: Should the availability of Periodical Payment Orders affect the discount rate? If so, please give reasons. In particular:

- **Should refusal to take a PPO be taken as grounds for assuming a higher risk appetite? If so, how big a difference should this make to the discount rate?**
- **Should this assumption apply in cases where a secure PPO is not available?**

Q14: Do you agree that the discount rate should be set on the basis that claimants who opt for a lump sum over a PPO should be assumed to be willing to take some risk? If so, how much risk do you think the claimant should be deemed to have accepted? Please also indicate if you consider that any such assumption should apply even if a secure PPO is not available. Please give reasons.

Q15: Do you consider that different rates should be set for different cases? Please give reasons. If so please indicate the categories that you think should be created.

Q16: Please also indicate in relation to the categories you have chosen whether there are any special factors that should be taken into account in setting the rate for that category.

Q17: Should the court retain a power to apply a different rate from the specified rate if persuaded by one of the parties that it would be more appropriate to do so? Please give reasons.

Q18: If the court should have power to apply a different rate, what principles should apply to its exercise?

Q19: Do you consider that there are any specific points of methodology that should be mandatory? Please give details and reasons for your choice.

Q20: Do you agree that the law should be changed so that the discount rate has to be reviewed on occasions specified in legislation rather than leaving the timing of the review to the rate setter? If not, please give reasons.

Q21: Should those occasions be fixed or minimum periods of time? If so, should the fixed or minimum periods be one, three, five, ten or other (please specify) year periods? Please give reasons.

Q22: When in the year do you think the review should take effect? Please give reasons.

Q23: Do you agree that the rate should be reviewed at intervals determined by the movement of relevant investment returns? If so, should this be in addition to timed intervals or instead of them? What do you think the degree of deviation should trigger the review?

Q24: Do you agree that there should be a power to set new triggers for when the rate should be reviewed? If not, please give reasons.

Q25: Do you consider that there should be transitional provisions when a new rate is commenced? If so, please specify what they should be and give reasons.

Q26: Do you consider that the discount rate should be set by:

- **a) A panel of independent experts? If so, please indicate how the panel should be made up.**
- **b) A panel of independent experts subject to agreement of another person? If so, on what terms and whom?**

  Would your answers to the questions above about a panel differ depending on the extent of the discretion given to the panel? If so, please give details
- **c) The Lord Chancellor and her counterparts in Scotland or another nominated person following advice from an independent expert panel? If so, on what terms?**
- **d) The Lord Chancellor and her counterparts in Scotland as at present?**
- **e) Someone else? If so, please give details.**

Q27: Do you consider that the current law relating to PPOs is satisfactory and does not require change? Please give reasons.

Q28: Do you consider that the current law relating to PPOs requires clarification as to when the court should award a PPO? If so, what clarification do you consider necessary and how would you promulgate it?

Q29: Do you consider that the current law relating to PPOs should be changed by creating a presumption that if a secure PPO is available it should be awarded by the court? If so, how should the presumption be applied and on what grounds could it be rebutted?

Q30: Do you consider that the current law relating to PPOs should be changed by requiring the court to order a PPO if a secure PPO is available? If so, what conditions should apply?

Q31: Do you consider that the cost of providing PPOs could be reduced? If so, how.

Q32: Please provide details of any costs and benefits that you anticipate would arise as a result of any of the approaches described above.

Q33: Please provide any evidence you may have as to the use or expected use of PPOs in the light of the change in the rate and more generally.

Impact Assessment

Q34: Do you agree with the impact assessment that accompanies this consultation paper? If not, please give reasons and evidence to support your conclusions.

Equalities Statement

Q35: Do you think we have correctly identified the range and extent of effects of these proposals on those with protected characteristics under the Equality Act 2010?

Q36: If not, are you aware of any evidence that we have not considered as part of our equality analysis? Please supply the evidence. What is the effect of this evidence on our proposals?

Thank you for participating in this consultation exercise.

Annex 1 – Named Consultees

Main professional bodies

Bar Council

Chartered Institute of Legal Executives

Faculty of Advocates

Institute and Faculty of Actuaries

Law Society

Law Society of Scotland

Main representative groups

Association of British Insurers (ABI)

Association of Personal Injury Lawyers (APIL)

Association of Insurance and Reinsurance Run-Off Companies (AIRROC)

Association of Professional Financial Advisers (APFA)

Automobile Association

British Insurance Brokers' Association

British Medical Association General Practitioners' Committee

Civil Justice Council

Confederation of British Industry

Convention of Scottish Local Authorities (CoSLA)

Federation of Small Businesses

Financial Conduct Authority

Financial Services Compensation Scheme

Forum of Complex Injury Solicitors (FOCIS)

Forum of Insurance Lawyers (FOIL)

Forum of Scottish Claims Managers

Her Majesty's Council of Circuit Judges

Judges of the Court of Session

Medical Protection Society

Medical Defence Union

Medical and Dental Defence Union of Scotland

Motor Accident Solicitors Society (MASS)

Motor Insurers' Bureau

NHS England

NHS Litigation Authority

NHS Wales

Personal Finance Society (PFS)

Prudential Regulation Authority

Royal Automobile Club

Royal College of General Practitioners

Scottish Civil Justice Council

Sheriffs' Association

Wealth Management Association (WMA)

Equality groups

Age Cymru

Age Scotland

Age UK England

Black and Ethnic Minority Infrastructure Scotland

Capability Scotland

Children First Scotland

Children's Society

Council of Ethnic Minority Voluntary Sector Organisations

Engender

Equality Network

Families and Friends of Lesbian and Gays

Fawcett Society

Gender Identity Research and Education Society (GIRES)

Glasgow Women's Library

Headway

Inclusion Scotland

Independent Living in Scotland

Institute for Race Relations

Interfaith Network for the UK

LGBT Youth Scotland

Muslim Council

Network of Sikh Organisations in the UK

Papworth Trust

Race Equality Foundation

RADAR

Rene Cassin

Scottish Disability Equality Forum

Scottish Human Rights Commission

Scottish Inter-Faith Council

Scottish Refugee Council

Scottish Transgender Alliance

Scottish Women's Convention

Stonewall Scotland

The Gender Trust

The Hindu Council UK

UK Disabled People's Council

Women's Aid

In accordance with standard practice, copies are also being sent to:

The Clerk of the Scottish Parliament's Justice Committee, the Scottish Parliament's Information Centre and all Scottish MEPs.

About you

Please use this section to tell us about yourself

Full name	
Job title or capacity in which you are responding to this consultation exercise (e.g. member of the public etc.)	
Date	
Company name/organisation (if applicable):	
Address	
Postcode	
If you would like us to acknowledge receipt of your response, please tick this box	☐ (please tick box)
Address to which the acknowledgement should be sent, if different from above	

If you are a representative of a group, please tell us the name of the group and give a summary of the people or organisations that you represent.

Contact details/How to respond

Please send your response by 11 May 2017 to:

Damages Discount Rate Consultation
Ministry of Justice
Civil Law and Justice Division
3rd Floor
102 Petty France
London SW1H 9AJ

Email: damagesdiscountrate@justice.gsi.gov.uk

Complaints or comments

If you have any complaints or comments about the consultation process you should contact the Ministry of Justice at the above address.

Extra copies

Further paper copies of this consultation can be obtained from this address and it is also available on-line at https://consult.justice.gov.uk/.

Alternative format versions of this publication can be requested from the above address.

Publication of response

A paper summarising the responses to this consultation will be published within three months of the closing date of this consultation. The response paper will be available on-line at https://consult.justice.gov.uk/.

Representative groups

Representative groups are asked to give a summary of the people and organisations they represent when they respond.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Ministry.

The Ministry will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Impact Assessment

An impact assessment has been prepared and is available with this consultation paper. Comments on the impact assessment are very welcome.

Q34: Do you agree with the impact assessment that accompanies this consultation paper? If not, please give reasons and evidence to support your conclusions.

Welsh Language Impact Test

The policy proposals do not affect the delivery of MoJ services in Wales. A Welsh language version of the executive summary of the proposals will be available at http://www.justice.gov.uk/publications/corporate-reports/moj/2010/welsh-language-scheme

Equalities Statement

The Personal Injury Discount Rate: How it should be set in future

Introduction

The core issues examined in the consultation paper are:

- **What principles should guide how the rate is set?**
- **How often should the rate be set?**
- **Who should set the discount rate?**
- **Should periodical payment orders (PPOs) be made more often?**

Equality Issues

Section 149 of the Equality Act 2010, the Public Sector Equality Duty (PSED), provides that:

> "A public authority, must in the exercise of its functions, have due regard to the need to-
>
> (a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this [the 2010] Act;
>
> (b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
>
> (c) foster good relations between persons who share a relevant protected characteristic and those who do not share it."

Paying 'due regard' needs to be considered against the nine "protected characteristics" under the Equality Act 2010 – namely race, sex, disability, sexual orientation, religion and belief, age, marriage and civil partnership, gender reassignment, pregnancy and maternity.

Equality considerations

Direct discrimination

The possible changes to the discount rate and PPOs under consideration in this paper are not directly discriminatory within the meaning of the Equality Act 2010 as they apply equally to all claimants; we do not consider that the proposals would result in people being treated less favourably because of their protected characteristic.

Indirect discrimination

What principles should guide how the rate is set? The discount rate applies to lump sum awards of damages for future pecuniary loss: typically, loss of future earnings and costs of future care. The rate is in essence a rate of return on investments assumed to be made by claimants as a class. For these purposes under the present law claimants are not differentiated. There is one rate for all claimants save that the court may depart from that rate when persuaded another rate is more appropriate. In practice the court seems never to have done so.

The rate is set by reference to assumed investments. The ability to make these investments is not limited by any protected characteristics – even child claimants and claimants lacking mental capacity have representatives who will invest on their behalf.

The rate will be higher if set by reference to investments with high returns and lower if set by reference to investments with low returns. A higher rate will translate into a smaller lump sum award and vice versa.

The consultation paper seeks views on how the level of the discount rate should be determined.

Many seriously injured personal injury victims will have physical and mental disabilities as a result of the injury. Disabled persons may therefore be more highly represented in the population of claimants than among the population generally. Among the most seriously long term injured and in receipt of the largest awards the proportion of very young children injured at birth (cerebral palsy sufferers, for example) and young men injured in road accidents may well be higher than the proportion of babies and young men in the population at large. These groups might be more affected by the choice of a particular methodology for the setting of the rate than others. How, relative to the present legal situation, people with these or other protected characteristics will be affected by proposed changes in the law will only be ascertainable when there are detailed proposals to consider. At present the most we can say in relation to claimants is that there may be equalities outcomes to consider in deciding whether to proceed with the reforms and that it is likely that the difference in outcomes will be more pronounced the further the proposals move from the position under the present law, which assumes a very low risk profile, to a position assuming a higher risk profile.

Defendants would be likely to benefit if the discount rate were to be higher in future compared to the rate that would have been set under the current law. If the rate decreased relative to the level at which it would have been set under the present law, the opposite would be true. The interests of defendants are usually represented by their insurers. The protected characteristics of defendants are not in practice relevant to the setting of the discount rate.

This is not to say that the position under the present law is necessarily the best and fairest solution possible. It may be that certain claimants are being over-compensated by way of the effect of artificially low investment risk profile assumptions used in the setting of the rate. It may also be the case that there are people with protected characteristics who are paying more for certain services as a result of this overcompensation (for example, through tax or increased insurance premiums).

The consultation is not the first time that some of these issues have been addressed. Responses to the 2013 consultation “The Damages Act 1996: The Discount Rate: Review of the Legal Framework” supported the view that personal injury claimants may be more likely to have a disability (for example, as a result of an accident that is the subject of their claim) when compared to the population as a whole. More generally, however, it remained unclear whether particular groups of claimants with protected characteristics would be affected differentially by the changes to the discount rate.

How often should the rate be set?

The rate is set at present by the Lord Chancellor from time to time. The consultation paper asks whether the rate should have to be reviewed at specified points in time defined by length, movements in returns on investments or otherwise. This might lead the rate to be changed more often than in the past. The changes, if any, will, however, affect all persons equally, irrespective of their protected characteristics, so we do not expect any particular disadvantage in relation to them.

Who should set the discount rate?

The rate is at present set by the Lord Chancellor after consulting HM Treasury and the Government Actuary. The paper asks whether the rate should be set by an expert panel, with or without government intervention; whether there should be an advisory expert panel; or whether the rate should be set by the Lord Chancellor or some other designated person. Changing the law in this respect will affect all persons equally, irrespective of their protected characteristics, so we do not expect any particular disadvantage in relation to them.

Should periodical payment orders (PPOs) be made more often?

Awards of damages may be made by a lump sum or a PPO (or a combination of the two). The court may insist on a PPO, but otherwise it is for the parties to agree whether or not one should form part of the award. The PPO must be adequately secure. Awards may combine a lump sum for future loss and a PPO.

PPOs are not risk free but provide a very high degree of certainty that the expected costs (for example, of future care) will be met in full and at the right time, which removes the uncertainty inherent in relying on returns from investment of a lump sum. The actual costs to be met may differ.

The effect of encouraging the use of PPOs in relation to the equality duty is therefore uncertain. A move to PPOs would benefit persons with protected characteristics to the extent that they would benefit from the receipt of a PPO rather than a lump sum, but it is not known how likely this is to occur or whether the decision to take a PPO would be determined or influenced by the protected characteristics of the claimant. A change in the use of PPOs would, however, be more likely to affect persons with a disability relative to their numbers in society as a whole as any long term personal injury claimant is likely to be disabled to some extent as a result of the injury.

The 2013 consultation paper also considered whether the balance between lump sum and PPO awards should be altered. The overall response was that the current balance was broadly right and there were few comments about the equalities impact of altering the balance between PPOs and lump sums.

The indirect effect of increasing the use of PPOs on society generally would depend on the cost to the insurance industry of providing these long term products. If, relative to a lump sum, the use of a PPO were to be more expensive for the defendant then it might be expected that the additional cost would potentially increase the cost of insurance products. The distribution of this extra cost across customers would be a matter for the insurers but it is possible that people considered more likely to cause personal injury, for example, young or older drivers, might be disproportionately affected as against the customers of insurance companies generally. It is possible therefore that there may also be negative equalities impacts of changes to the law regarding the use of PPOs.

Discrimination arising from disability and duty to make reasonable adjustments

The policy issues under consideration as to how the discount rate is to be set and whether the use of PPOs should be encouraged will affect the manner in which awards of damages are payable and the amounts to be paid. We do not anticipate that the outcome of the consideration will give rise to discrimination arising from disability or to the need for reasonable adjustments to be made.

Harassment and victimisation

We do not consider there to be a risk of harassment or victimisation as a result of these proposals.

Advancing equality of opportunity

Consideration has also been given to how these proposals impact on the duty to advance equality of opportunity by meeting the needs of claimants who share a particular characteristic, where those needs are different from the need of those who do not share that particular characteristic. We do not anticipate that changing the law relating to the discount rate or encouraging the use of PPOs will provide a significant opportunity to advance equality of opportunity in this context.

Fostering good relations

Consideration has been given to this objective that indicates it is unlikely to be of particular relevance to the proposals.

Conclusion

The propositions under consideration as to how the discount rate should be set and the related question of whether the use of PPOs should be encouraged engage the public sector equality duty and could have both positive and negative equalities impacts.

We cannot at this stage predict what will be the outcome of the consultation. We hope that the responses to the consultation will provide evidence of behaviours relating to lump sum and PPO awards that will enable a more accurate assessment of the equalities impacts of any changes to be made. As the initial indications are that some people may benefit from the changes, but that others may not, we will be considering the outcome of the consultation in relation to the equalities implications from a range of perspectives.

Q35: Do you think we have correctly identified the range and extent of effects of these proposals on those with protected characteristics under the Equality Act 2010?

Q36: If not, are you aware of any evidence that we have not considered as part of our equality analysis? Please supply the evidence. What is the effect of this evidence on our proposals?

Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

https://www.gov.uk/government/publications/consultation-principles-guidance

© Crown copyright 2016

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

Alternative format versions of this report are available on request from damagesdiscountrate@justice.gsi.gov.uk.