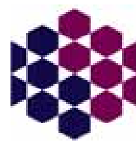


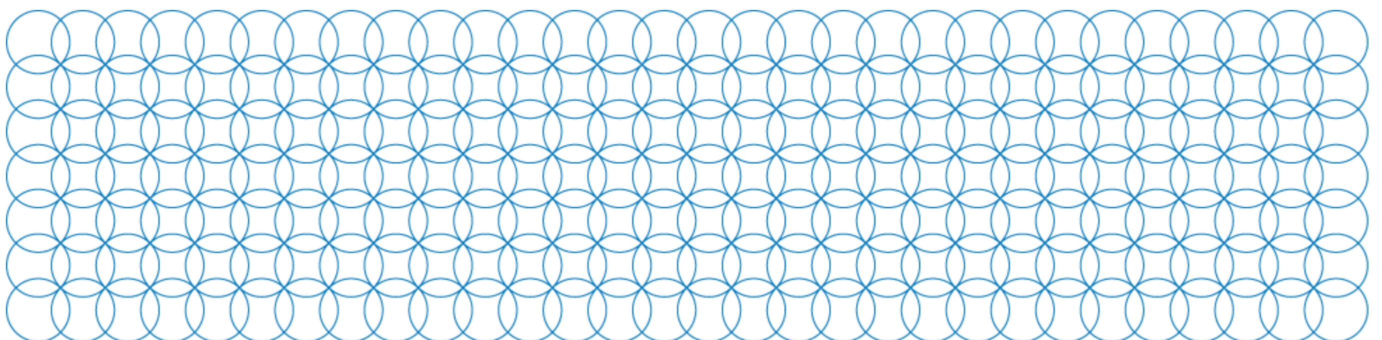
Damages Act 1996: The Discount Rate

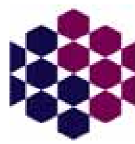
How should it be set?

Consultation Paper CP12/2012

This consultation begins on 01 August 2012

This consultation ends on 23 October 2012





Damages Act 1996: The Discount Rate

How should it be set?

A joint consultation produced by the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland. It is available on the Ministry of Justice website at www.justice.gov.uk

About this consultation

To:	All those with an interest in personal injury claims
Duration:	From 01/08/2012 to 23/10/2012
Enquiries (including requests for the paper in an alternative format) to:	Damages Discount Rate Consultation Ministry of Justice Post point 6.21 102 Petty France London SW1H 9AJ Tel: 020 3334 6964 Email: damagesdiscountrate@justice.gsi.gov.uk
Enquiries relating specifically to Scotland to:	Justice Directorate St Andrews House Regent Road Edinburgh EH1 3DG Tel: 0131 244 6931 Email: damages@scotland.gsi.gov.uk
Enquiries relating specifically to Northern Ireland	Civil Justice Policy and Legislation Access to Justice Directorate Massey House Stormont Estate Belfast BT4 3SX Tel: 028 90169541 E-mail: atojconsultation@dojni.x.gsi.gov.uk
How to respond:	Please send your response by 23/10/2012 to: Damages Discount Rate Consultation Ministry of Justice Post Point 6.21 102 Petty France London SW1H 9AJ Tel: 020 3334 6964 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 the Department of Justice in Northern Ireland.

Response paper:	A response to this consultation exercise is due to be published by 22/01/2012 at: http://www.justice.gov.uk, http://www.scotland.gov.uk and http://www.dojni.gov.uk

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Executive summary

Damages awarded by a court in a personal injury case are intended to compensate the claimant[1] for the loss wrongfully caused to him or her by the injury.

In principle, this compensation is intended to put the claimant back in the position he or she would have been in if it had not been for the wrongfully caused injury. The compensation should, therefore, be as full as possible, but should not under-compensate or over-compensate the claimant.

Despite the availability of periodical payments as a means of compensating the claimant, the majority of awards of damages for personal injury are paid in a once and for all settlement. The claimant therefore receives all the compensation for future care and future loss of earnings, perhaps for many years into the future, when the award is paid. As this sum may be invested by the claimant, allowance has to be made for its accelerated receipt otherwise the claimant would probably be over-compensated. The lump sum is therefore reduced by the application of a discount rate. In practice, no separate calculation is necessary because the actuarial tables used already take into account the effect of a range of discount rates. The parties to the litigation must simply apply the relevant one.

In England and Wales a general rate is set by the Lord Chancellor under section 1 of the Damages Act 1996, though the court may decide that another rate is appropriate in an individual case. In their jurisdictions, the Scottish Ministers and the Department of Justice in Northern Ireland respectively are provided by section 1, as amended, with a role that is similar to the Lord Chancellor's. Using the general rate removes the need for claimants and defendants[2] to argue what the appropriate discount rate should be in their individual case, saving significant amounts of time and costs.

In deciding what the discount rate should be the Lord Chancellor is guided by the principles laid down by the House of Lords in the 1998 case of *Wells v Wells*.[3] Claimants are therefore assumed to be in a special category of investors who need to be sure that money will be available to meet their future expenses as they arise. They are deemed to be willing to accept only a low degree of risk and their investments are assumed to be correspondingly low yielding. The discount rate is intended to reflect the real rate of return on these investments. The claimant, however, remains free to invest the award as he or she thinks fit.

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[1] In Scotland, a claimant is known as a pursuer and in Northern Ireland as a plaintiff.

[2] In Scotland, a defendant is known as a defender.

[3] These principles are also relevant for Scotland and for Northern Ireland, even though *Wells v Wells* was an English case.

For England, Wales and Northern Ireland, the present discount rate of 2.5% was set in 2001[4] largely by reference to the simple three year average of the gross redemption yields of Index-Linked Government Gilts (ILGS) subject to an adjustment for the yields of near maturity stock.

Yields on ILGS have been declining for some time and there is a risk that the present rate may now be too high. In the light of this possibility the Lord Chancellor, the Scottish Ministers and the Department of Justice in Northern Ireland have each decided that the discount rate ought to be reviewed to ensure that it is still set at an appropriate rate. As part of those exercises, following advice from the relevant statutory consultees,[5] they have decided to consult on how the rate ought to be set. The purpose of this consultation paper is to seek views on the methodology that should be used in setting the rate.

In general terms, the discount rate is the rate of return to be expected from the investment of a lump sum award of damages for future loss. The methodology to be used in setting the rate will, in effect, define the types of investments by reference to whose yields, subject to appropriate adjustments, the discount rate is to be set. There may not be any single ‘right' rate but the overriding aim is to set the rate as accurately as possible so that under- or over-compensation by reason of the accelerated payment of the future losses is avoided so far as possible.

Two broad options are considered: (a) to use an ILGS-based methodology applied to current data; and (b) to move from an ILGS based calculation to one based on a mixed portfolio of appropriate investments applied to current data.

We invite views on both options as well as on any other issues consultees wish to draw to our attention, either generally or specifically in relation to one or more of the jurisdictions within the United Kingdom.

Identifying the appropriate methodology will not of itself have any direct effect on awards of damages, but, depending on its size, a change in the discount rate may significantly increase or decrease the sums payable in awards of damages for personal injuries. This follows inevitably from the application of the principle of full compensation. However, the consequences for defendants of paying awards are not a matter to be taken into account in setting the discount rate.

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[4] For Scotland, the present discount rate of 2.5% was set in 2002.

[5] The Government Actuary for all three jurisdictions and HM Treasury and the Department of Finance and Personnel for England and Wales and Northern Ireland respectively.

Introduction

This paper sets out for consultation questions relating to the methodology to be used by the Lord Chancellor and his counterparts in Scotland and Northern Ireland in independently setting the discount rate for personal injury damages in their respective jurisdictions. The consultation is aimed at people and organisations with an interest in personal injury claims and damages in the UK.

This consultation – which is undertaken jointly on behalf of the UK, Scottish and Northern Irish administrations[6] – is conducted in line with the Ministry of Justice Code of Practice on Consultation and falls within the scope of the Code. The consultation criteria, which are set out on page 120, have been followed.

An impact assessment has been prepared and is included in this consultation paper.

Copies of the consultation paper are being sent to:

Main professional bodies

Bar Council

General Council of the Bar of Northern Ireland

Institute of Legal Executives

The Actuarial Profession

The Faculty of Advocates

The Law Society

The Law Society of Northern Ireland

The Law Society of Scotland

Main representative groups

Association of British Insurers (ABI)

Association of Personal Injury Lawyers (APIL)

Association of Run-Off Companies

Civil Justice Council

[6] The consultation is being undertaken jointly, in light of the apparent commonality of issues across the various jurisdictions of the UK, for the sake of efficiency. It remains the case, however, that the Lord Chancellor's subsequent decisions on the setting of the discount rate for England and Wales will be made independently, as will the decisions of the Scottish Ministers and the Department for Justice in Northern Ireland for their respective jurisdictions.

Convention of Scottish Local Authorities (CoSLA)
Federation of Small Businesses
Federation of Small Businesses Northern Ireland
The Forum of Complex Injury Solicitors (FOCIS)
The Forum of Insurance Lawyers (FOIL)
The Forum of Scottish Claims Managers
Her Majesty's Council of Circuit Judges
Her Majesty's Council of County Court Judges (Northern Ireland)
High Court Judges Northern Ireland
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
Office of the Lord Chief Justice of Northern Ireland
Sheriffs Association

Equality groups

Age Concem Cymru
Age Scotland
Age Northern Ireland
Age UK England
Black and Ethnic Minority Infrastructure Scotland
Capability Scotland
Carers Northern Ireland
Children First Scotland
Children in Northern Ireland
Children's Law Centre Northern Ireland
Children's Society
Churches Together in Britain and Ireland
Council of Ethnic Minority Voluntary Sector Organisations
Disability Action Northern Ireland
Engender
Equality Commission for Northern Ireland

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
Northern Ireland Council for Ethnic Minorities
Northern Ireland Gay Rights Association
Northern Ireland Human Rights Commission
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
Womens Aid
Women's Forum Northern Ireland

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

- the Clerk of the Scottish Parliament's Justice Committee, to the Scottish Parliament's Information Centre and to all Scottish MEPs;
- the Clerk of the Northern Ireland Justice Committee and the Speaker of the Northern Ireland Assembly

In addition responses are welcomed from anyone with an interest in or views on the subject covered by the paper.

The proposals

Part 1 – Preliminary

Aim of this paper

1. The discount rate is the rate used by the courts in the UK to calculate the amount by which an award of damages for personal injuries paid by way of a lump sum should be reduced to allow for the accelerated payment of the expenses to be incurred. The aim of this paper is to obtain views on what methodology the Lord Chancellor and his counterparts in Scotland and Northern Ireland should use when reviewing the rate under section 1 of the Damages Act 1996.

2. As amended, section 1 now provides that:

   1 Assumed rate of return on investment of damages.

   (1) In determining the return to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury the court shall, subject to and in accordance with rules of court made for the purposes of this section, take into account such rate of return (if any) as may from time to time be prescribed by an order made by the Lord Chancellor.

   (2) Subsection (1) above shall not however prevent the court taking a different rate of return into account if any party to the proceedings shows that it is more appropriate in the case in question.

   (3) An order under subsection (1) above may prescribe different rates of return for different classes of case.

   (4) Before making an order under subsection (1) above the Lord Chancellor shall consult the Government Actuary and the Treasury; and any order under that subsection shall be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.

   (5) In the application of this section to Scotland–

      (a) for the reference to the Lord Chancellor in subsections (1) and (4) there is substituted a reference to the Scottish Ministers; and

      (b) in subsection (4)–

         (i)”and the Treasury” is omitted; and

         (ii)for “either House of Parliament” there is substituted “the Scottish Parliament”.

(6) In the application of this section to Northern Ireland—

(a) for the reference to the Lord Chancellor in subsections (1) and (4) there is substituted a reference to the Department of Justice in Northern Ireland; and

(b) in subsection (4)—

(i)for the reference to the Treasury there is substituted a reference to the Department of Finance and Personnel in Northern Ireland; and

(ii)for "by statutory instrument" to "Parliament" there is substituted "by statutory rule for the purposes of the Statutory Rules (Northern Ireland) Order 1979, and is subject to negative resolution within the meaning of section 41(6) of the Interpretation Act (Northern Ireland) 1954"

3. We invite replies to the questions raised in this paper either generally or specifically by reference to one or more of the jurisdictions in the United Kingdom.

Background

What is the discount rate?

4. The objective of an award of damages is to put the injured person, in so far as money can do so, in as nearly as possible the same position as he or she was in before the injury. The award will be made on the basis that it will cover all the loss arising from the cause of action, whether the loss be past, present or future, certain or contingent.

5. Damages may be awarded as a lump sum or by way of periodical payments or a combination of both. Indeed, although it does not bear directly on the question of how the discount should be set, the courts in England, Wales and Northern Ireland have, since 2005, been required to consider whether awards for future loss should be made in the form of periodical payments rather than a lump sum.[7]

6. The court's aim, while mindful that the assessment of damages can never be an exact science,[8] is to award an amount of money that will neither under-compensate nor over-compensate the claimant. Where lump sum damages are awarded for serious personal injuries, the amount of the award may need to take into account the claimant's loss of earnings, care costs and other future expenses for many years into the future. The claimant can then use the money he or she receives (and any money it generates) to meet his or her expenses as they arise. In calculating the

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[7] Damages Act 1996, ss 2 and 2B (as introduced by Courts Act 2003, s.100(1) which did not extend to Scotland).

[8] Hunt v Severs [1994] 2 WLR 602, 613, Lord Bridge.

award the court will, however, reduce the lump sum to be awarded to take account of the fact that it is received in the form of an immediate payment which can be invested.

7. The working of the discount rate is illustrated by the following example. If one assumes that a claimant will require future care at an average annual cost of £10,000 on a life expectancy of 20 years, then, disregarding changes in the value of money, if the court were to award £200,000 the plaintiff would be over-compensated. This is because the £10,000 needed to purchase care in the twentieth year should have been earning interest for 19 years from when the payment is made. The amount by which the sum of £200,000 must be discounted is determined by the return that is expected from the investments it is assumed that the claimant will make. Thus, if one assumes a net return of 5 per cent., the sum payable would be £130,900, whilst at a net return of 3 per cent., the figure would be £153,200.[9]

8. The discount rate needs to be applied in the calculation of each individual lump sum award of damages, but in practice the parties to the litigation refer to established actuarial tables rather than having to carry out a separate calculation themselves. It would theoretically be possible, taking into account the individual circumstances of each case, to calculate an appropriate discount rate on each occasion. This could, for example, take into account the expected duration of the award and the degree of investment risk that should be taken. There might, for example, be a different discount rate applied in the case of a child inflicted with serious life long health problems and the case of an adult suffering from injuries that do not significantly impair long term earning potential. However, to simplify the process of litigation, the practice has been to apply a general rate. This avoids the cost of obtaining what would probably be expensive expert evidence.

9. Section 1 of the Damages Act 1996 requires that in determining a general discount rate it is necessary to decide what the return on the money assumed to be invested will be. There are of course many different types of investment and many different ways to combine them in portfolios for individual investors, whose circumstances may also differ widely.[10] The

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[9] Assuming also for these purposes that the payment for care is made annually at the start of each year.

[10] The variety is illustrated by the division of the sample surveyed into four bands in the Law Commission's report Personal Injury Compensation: How much is enough? A study of the compensation experiences of victims of personal injury (Law Com 225) published in 1994. Lump sums might, for example, be awarded to an adult manual worker who had seriously injured a hand in an accident and lost most of its functionality; an adult care worker who had suffered a back injury while lifting; a teenager who suffered botched cosmetic surgery and, finally, a child suffering brain damage at birth due to medical negligence. The size of the awards would differ

nature of the investments assumed to be made for the setting of a general discount rate will be influenced by the degree of risk that the notional investor is deemed to be willing to accept.

10. One option is to invest in government bonds. These are bonds issued by national governments to finance their borrowing requirements, and which are considered to be among the safest assets to hold in any particular market. Governments sell the bonds with the promise that they will pay back the money invested at a date in the future. These bonds can be bought and sold, and are identified by their coupon rate and maturity date. The coupon is the fixed cash payment (in the case of 'nominal' or 'conventional' gilts) paid as interest on the bond at fixed intervals. A bond bearing the name 4 3/4% Treasury Gilt 2020 indicates that at the time of issue the market rate of interest was 4.75% and the bond will be redeemed in 2020. The holder of this bond receives £4.75 cash per £100 of stock (the principal) each year in two semi-annual payments until 2020, when he or she will also receive the principal sum repayment of £100.

11. Bonds are also issued by corporate bodies, including local authorities and private corporations. They come in many forms. The degree of market risk attached to these investments is derived primarily from the creditworthiness of the issuing body, but can also incorporate other risks (e.g. currency risk and liquidity risk).

12. Additionally, many governments have issued 'index-linked' bonds. Since 1981, the United Kingdom Government has issued gilts[11] linked to the Retail Prices Index (RPI). Index-linked gilts (ILGS) are similar to conventional gilts except that their semi-annual coupons and principal payment are adjusted in line with movements in the RPI.

13. Other options include investing in shares, otherwise known as equities; investing in commodities or currency; or placing monies on deposit to earn interest. These investments may be direct or indirect. These different types of investment all carry different amounts of risk relative to one another and to government bonds. The yield will usually reflect the degree of risk attached.

History of the discount rate

14. Discount rates are necessary where the value of money is not constant. They are applied in many situations. In relation to lump sum awards of damages for personal injury, the practice of the courts for many years before the late 1990s was to take a discount rate of 4.5% net of tax (6% gross). This was considered to be the appropriate rate for a stable currency and to provide adequate protection against inflation. It was

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significantly to reflect the different damage suffered and the different care required. See Law Com 225 pp 5 and 6.

[11] Gilts is the name given to bonds issued by the UK Government.

based on an assumption that the claimant would invest in a mixed basket of equities and government bonds and produce this return above inflation. No other specific allowance was made for inflation on the assumption that prudent investment of the capital sum awarded would protect the plaintiff against it. As Lord Diplock said: "Inflation is taken care of in a rough and ready way by the higher rates of interest obtainable as one of the consequences of it and no other practical basis of calculation has been suggested that is capable of dealing with so conjectural a factor with greater precision."[12]

15. However, over time concerns arose that this approach exaggerated the rate of return that claimants could reasonably be expected to achieve and was therefore causing claimants to be under-compensated – in some cases, significantly so. These concerns led a working party chaired by Sir Michael Ogden QC to recommend in 1984 that the discount rate should be based on the assumption that funds would be invested in ILGS.

16. Then, in 1992 the Law Commission published a consultation paper about structured settlements and lump sum damages.[13] In 1994 the Commission published its recommendations.[14] In relation to the discount rate the Commission recommended that a more actuarial approach should be taken in setting the discount rate and that the courts should be required to take into account the then rate of return on ILGS when determining the expected rate of return from the investment of the lump sum. The Commission considered that this would obtain the best reflection of market opinion as to what real interest rates would be in the future, but added that the parties should always have the opportunity to adduce evidence as to alternatives if they wished (for example, if returns on ILGS were unduly depressed). This recommendation was accompanied by other recommendations that the court should be able to depart from those rates where the circumstances required and that the Lord Chancellor should be able to prescribe an alternative indicator if no ILGS existed. Sir Michael Ogden QC's working group renewed its 1984 recommendation in 1994.

17. In 1996 the then Government introduced the Damages Bill, which became the Damages Act 1996 and implemented the Commission's recommendations, with modifications. The Bill made no reference to ILGS.

18. In 1998 the House of Lords, reversing the decision of the Court of Appeal,[15] set the discount rate to be applied by the courts at 3% by

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[12] *Cookson v Knowles* [1979] AC 556, 571H.

[13] Structured Settlements and Interim and Provisional Damages (1992) Consultation Paper 125.

[14] Structured Settlements and Interim and Provisional Damages Law Com 224.

[15] [1997] 1 All ER 673, CA.

reference to the average rate of return on ILGS.[16] This rate was set pending decisions by the Lord Chancellor and the Secretary of State for Scotland respectively as to whether they would prescribe a rate under the new power in section 1 of the Damages Act 1996.

19. On 27 June 2001, following public consultation, the then Lord Chancellor, Lord Irvine of Lairg, announced his decision to set the rate at 2.5% for England, Wales and Northern Ireland.[17] The reasons for the decision are explained in his statement of 27 July 2001, which is set out at Appendix A.1,[18] The rate was intended to last for a reasonable period of time and, notwithstanding changes in the rates of return of ILGS, it remains in force. In February 2002 the then Scottish Justice Minister, Jim Wallace MSP, announced his decision also to set the discount rate at 2.5% for Scotland. His reasons are set out in the Executive Note at Appendix A.2. This rate also remains in force.

The present consultation

20. In view of the decline in ILGS yields the Lord Chancellor and his counterparts in Scotland and Northern Ireland have decided to review the discount rate and, in the light of advice from the Government Actuary and, for England and Wales, HM Treasury and, for Northern Ireland, the Department of Finance and Personnel, have also decided to re-examine the methodology to be used in setting the rate. This consultation forms part of that re-examination.

21. In setting the rate the Lord Chancellor and his counterparts in Scotland and Northern Ireland are guided by the principles laid down by the House of Lords in the 1998 case of *Wells v Wells*. We are not consulting on whether this should be the case.

22. Taking into account the principles laid down in *Wells v Wells*,[19] we have identified two broad methodologies that might be adopted to set the discount rate:

    (a) To use an ILGS-based methodology applied to current data (option 1);

    (b) to move from an ILGS based calculation to one based on a mixed portfolio of appropriate investments (option 2).

23. These options are considered to be potentially consistent with those principles, but we have not reached a view on which of these options –

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[16] *Wells v Wells* [1999] 1 AC 345.

[17] Hansard 27 June 2001 HoL vol 626 col 470 WA 12.

[18] This statement was laid in the libraries of both Houses of Parliament on 27 July 2001. It follows on from the document: Section 1 of the Damages Act 1996: Reasons for the decision, which was laid in those libraries on 27 June 2001.

[19] [1999] 1 AC 345.

or indeed any other methodology – should be adopted. Whatever that methodology may be, it will have to be consistent with the power conferred by section 1 of the Damages Act 1996. The methodology will aim to produce a discount rate that will give effect to the principle of full compensation on the basis of investments that would be made under an appropriate low risk investment strategy. It is, however, for individual claimants to decide what actually to do with their awards.

24. In setting the rate the expectation will be that any new rate should endure for a reasonable length of time. However, a balance may need to be struck as insufficiently frequent change may increase the risk of inaccurate rates, whilst over-frequent changes could engender uncertainty and make it more difficult and expensive to settle cases.

Impact assessment

25. The House of Lords in *Wells v Wells* noted that for the purposes of calculating the discount rate, the consequences for defendants of paying awards to claimants are not a matter to be taken into account. We are not consulting on the applicability of this principle in this consultation. Thus, while it remains necessary to undertake an assessment of the impact on all parties, the rate can only be set at a level which will fairly compensate claimants. The impact assessment must be seen in that context.

26. Significant sums of money are ordered to be paid by the courts in respect of lump sum awards of damages each year. For example, in England the National Health Service Litigation Authority paid out on average £350 million annually in lump sum damages for clinical negligence from 2008-09 to 2010-11.[20] Figures are not readily available for the total of sums ordered by the courts against private defendants generally. However, the Association of British Insurers (ABI) gave evidence to the Transport Select Committee in December 2010 that its members believed reducing the discount rate from the current level of 2.5% would lead to significant and immediate increases in settlements, which would have both a retrospective effect on claims filed but not yet settled and an ongoing effect on future claims. ABI warned in its evidence that these substantial and immediate increased costs on insurers were likely to be passed onto consumers through higher premiums.[21]

27. The effect of changes in the discount rate on individual awards of damages is illustrated by the case of a claimant who was awarded a lump sum of £5,523,092.64 following the application of a discount rate of 2.5%.[22] Had the discount rate been 1.5% the award would have been

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[20] Hansard 8 June 2011 col 358W.

[21] http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtran/writev/591/cmi13a.htm

[22] Kingsbury v Burton [2007] EWHC 2091 (QB).

£6,354,329.53 and £7,537,628.33 had it been 0.5%. Whether a change in the discount rate leads to an increase or decrease in the size of awards will depend on how rates have changed since the rate was last set. Any methodology will therefore be capable of producing increases or decreases on different occasions.

28. Any change in the discount rate is therefore highly significant to claimants and defendants in personal injury cases although, as set out above,[23] it is the effect on awards to claimants which will inform the choice of methodology for setting the rate. As many of these defendants are insured, increases or decreases in the discount rate can be expected to affect insurance premiums more generally.

29. However, these effects would only flow from a change in the discount rate and this consultation is not concerned with the actual setting of the rate itself. The purpose of this consultation is to help the Lord Chancellor and his counterparts in Scotland and Northern Ireland identify the method by which the discount rate should be set. The initial impact assessment accompanying this consultation therefore analyses the potential effect of each of the different methodologies under consideration in a qualitative way. The impact assessment is at Appendix B. We discuss the impact assessment and invite views at paragraphs 101–107 below.

Small Firms

30. As part of the impact assessment process we have considered the effect of the choice of the method by which the discount rate is set on small firms. As the rate is set for use by the court in quantifying an established legal liability any effect will be indirect and will not affect the operations or performance of small firms or affect them differently from other businesses. We discuss the possible effect of the issues discussed in this paper on small firms at paragraphs 108–110 below.

Equality impact assessment

31. Pursuant to concern for equalities considerations – including the statutory legislative equalities duties on government arising from the Equality Act 2010 in England, Wales and Scotland – we are undertaking an Equality Impact Assessment to consider how the way in which the discount rate is to be set will impact on different groups of people (either positively or negatively), particularly with reference to the protected characteristics of disability, race, sex, gender reassignment, age, marriage and civil partnership, religion and belief, pregnancy and maternity, and sexual orientation. In choosing the method by which the discount rate will be set we will need to be mindful of the effect of the application of the method chosen on people with protected characteristics and would welcome evidence and views on this subject. The equality impact assessment is at

[23] Para 23.

Appendix C. It will be completed in the light of the responses to this consultation and include any further relevant evidence of equalities impacts. The Department of Justice, Northern Ireland, has carried out an equality screening pursuant to its statutory duties under section 75 of the Northern Ireland Act 1998. A copy of this assessment is at Appendix D. The assessment will be completed in light of the responses to this consultation.

Regulatory policy: One-In, One-Out and Sunsetting Policies and the Micro-business and Start Up Moratorium

32. Ministers have implemented several policies to promote growth by preventing the proliferation of unnecessary regulation. In England and Wales, for example, these policies include the One-In, One-Out policy; the Sunsetting policy and the Micro-business and Start-Ups Moratorium. Such policies, however, do not apply to the choice of the method by which the discount rate should be set or the ultimate setting of the rate because the discount rate is not a regulation as defined for these purposes.[24] This non-application is appropriate because the purpose of setting the rate is ultimately to ensure that lump sum awards of damages payable in respect of a legal liability for personal injury are properly calculated. Claimants remain free to invest their awards as they wish. Defendants are of course obliged to pay the compensation ordered by the court for the injuries they have caused, but the choice of discount rate does not affect that obligation. Further, the court can apply a different rate in any case if one of the parties persuades it that such a course of action would be appropriate. It is for the Lord Chancellor and his counterparts in Scotland and Northern Ireland in the exercise of the discretion given by the Damages Act 1996 to decide when a change to the rate should be considered. Failure to exercise this discretion properly opens the Lord Chancellor and his counterparts to the risk of successful judicial reviews requiring them to review the rate.

Structure of this paper

33. In this part of this paper we have outlined the background to the proposal to consult. In Part 2 we describe the legal principles underlying the setting of the discount rate under section 1 of the Damages Act 1996 and explain the methodology applied in 1998 and in the setting of the current rate. In Part 3 we explain why the rate and the methodology are being reviewed. We then describe the options available and invite views on various matters that might be taken into account in setting the discount rate in Part 4. The questions asked in the preceding parts are brought together

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[24] "A rule or guidance with which failure to comply would result in the regulated entity or person coming into conflict with the law or being ineligible for continued funding, grants or other applied for schemes. This can be summarised as all measures with central force imposed by central government and other schemes operated by central government." One-In, One-Out (OIOO) Methodology July 2011 para 13.

in Part 5. Appendix A.1 and A.2 sets out the then Lord Chancellor's and Scottish Minister's announcement in 2001 and 2002 respectively. Appendices B and C contain respectively the impact assessment and equality impact assessment prepared to accompany this consultation paper. Appendix D contains the equality impact screening for Northern Ireland.

Abbreviations and definitions

34. References to ILGS are to Index-Linked Gilts; to HMT are to HM Treasury; to GA are to the Government Actuary; to RPI are to the General Index of Retail Prices; to CPI are to the Consumer Prices Index; and to ABI are to the Association of British Insurers. References to *Wells v Wells* are to the judgments of the House of Lords in the conjoined appeals of *Page v. Sheerness Steel Company Limited; Wells (Suing by Her Daughter and Next Friend Susan Smith) v. Wells; Thomas (Suing by His Mother and Next Friend Susan Thomas) v. Brighton Health Authority* [1999] AC 345. References to "near maturity ILGS" are to gilts for which the nominal value of the final coupon and redemption payments have become known with certainty.

Part 2 – Principles

The principles underlying the setting of the discount rate

35. In this Part of the paper we describe how the discount rate applicable to lump sum payments of damages for personal injury was set by the House of Lords in 1998 and by statutory instruments in 2001 and 2002, beginning with the underlying principles.

36. The basic principle to be applied in deciding the appropriate discount rate is that the award of damages for future expenditure is to place the injured party as nearly as possible in the same position he or she would have been in but for the injury. 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.[25]

37. In *Wells v Wells* the House of Lords decided that claimants in personal injury cases were not in the same position as ordinary investors and what was prudent for ordinary investors, who could ride out difficult times, was not necessarily prudent for personal injury claimants, particularly ones suffering from serious long term illness or disability.[26] Such claimants need an investment which will bring the money they require when they require it.

38. The House of Lords also concluded that this did not mean that the court had to reach any conclusion about what an individual claimant would **actually** do with the money when he or she received it.

39. Lord Hope of Craighead summarised the way that the discount rate should be set. He said "The measure of the discount is the rate of return which can reasonably be expected on that sum [of damages] if invested in such a way as to enable the plaintiff to meet the whole amount of the loss during the entire period which has been assumed for it by the expenditure of income with capital. … The assumptions to be made at the stage of selecting the discount rate are simply these. First, it is to be assumed that the lump sum will be invested in such a way as to enable the plaintiff to meet the whole amount of the losses or costs as they arise during the entire period while protecting the award against inflation, which can thus be left out of account. Secondly, it is to be assumed that that investment will produce a return which represents the market's view of the reward to be given for foregoing the use of the money in the meantime. This 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."[27]

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[25] *Wells v Wells* [1999] 1 AC 345, 390 per Lord Hope; and see the analysis of the Privy Council in *Simon v Helmot* [2012] UKPC 51.

[26] *Ibid* 366G, 386B-C, 392D, 396B and 403C-D.

[27] *Ibid* 390G – 391C.

40. Having identified the principles the House of Lords had then, in essence, to decide what rate of return was to be expected from an appropriate investment strategy. For this, it had to consider what investments were available in the market.

The methodology applied in Wells v Wells

41. In *Wells v Wells* the House of Lords acknowledged that it might be the case that the **average investor** would not regard it as imprudent to take some risk by investing in a mixed portfolio, including some equities. But, their Lordships concluded that, for a seriously injured claimant who was not in a position to take risks, and who wished to protect him- or herself against inflation, it was clearly prudent to invest in ILGS. As Lord Lloyd of Berwick put it: "What the prudent plaintiff needs is an investment which will bring him the income he requires without the risks inherent in the equity market; which brings us back to I.L.G.S."[28] As Mr Justice Dyson (as he then was) had explained at first instance "the advantages of calculating the discount rate on the basis of I.L.G.S are that inflation is taken care of precisely and not in a rough and ready way, and the net return is the actual net return on investments rather than a net return it is assumed by the court is enjoyed on notional prudent investments made at a time of stable currency."[29] The House of Lords also concluded that the greater risk of investing in equities was not even justified for a long term investment because, if there were a depressed market at an early stage, the claimant might have to draw on so much capital for his or her early needs that there would not be enough to provide for later years even if the market subsequently recovered.

42. In reaching its decision on the rate, the House of Lords considered that assuming an investment of the award of damages in ILGS was the most accurate way of calculating the present value of the loss which claimants would actually suffer in real terms. Lord Lloyd of Berwick explained the reasons for this as follows:

    > "How is the court to ensure that the plaintiff receives the money he will need to purchase the care he needs as the years go by despite the impact of inflation? In the past, the courts have solved this problem by assuming that the plaintiff can take care of future inflation in a rough and ready way by investing the lump sum sensibly in a mixed "basket" of equities and gilts. But the advent of the index-linked government stock (they were first issued in 1981) has provided an alternative. The return of income and capital on index-linked government stock ("I.L.G.S.") is fully protected against inflation. Thus the purchaser of £100 of I.L.G.S. with a maturity date of 2020 knows that his investment will then be worth £100 plus *x* per cent. of £100, where *x* represents the percentage increase in the retail price index between

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[28] *Ibid* 367B.

[29] [1996] PIGR 26, 26.

> the date of issue and the date of maturity (or, more accurately, eight months before the two dates). Of course if the plaintiff were to invest his £100 in equities it might then be worth much more. But it might also be worth less. The virtue of I.L.G.S. is that it provides a risk-free investment."[30]

43. Assuming investment in ILGS therefore enabled the court to arrive at a figure which would provide both full compensation for future losses, and for the capital sum to have expired at the end of the period covered by the award.

44. The House of Lords did not, however, simply apply the then rate of return on ILGS. Lord Hope advised that the figure [of the discount rate] should be expressed to no greater a degree of accuracy than one-half of a decimal point so that it would fit readily with the way that damages are calculated. He also added that to avoid further calculations the rate should be one which had regard in a general way to taxation on the index-linked income return on the investment, after the appropriate allowances, up to and including the standard rate. Taking into account these factors he concluded that "the evidence as to the average gross redemption yield for the last three years on I.L.G.S. with lives over five years, assuming an inflation rate of 5 per cent., indicates that for the time being 3 per cent. is the appropriate rate of net return to be expected from the investment of the sums to be awarded to the plaintiffs as damages for their future pecuniary loss."[31] Lord Lloyd, while agreeing with a rate of 3%, considered that a one year average would suffice.[32]

The setting of the current rate

45. In *Wells v Wells* the House of Lords envisaged that the Lord Chancellor and his counterpart in Scotland would adjust the rate in the light of changing circumstances under the then newly enacted but unexercised power in section 1 of the Damages Act 1996. In setting the rate for England, Wales and Northern Ireland at 2.5% in July 2001, Lord Irvine confirmed that he was applying the core legal principle articulated in *Wells v Wells* that "…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."[33] However, he also stated that "it is inevitable that any approach to setting the discount rate must be

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[30] *Wells v Wells* [1999] 1 AC 345, 364G – 365B

[31] *Ibid* 393E – F.

[32] *Ibid* 374D – 375B.

[33] [1999] 1 AC 345 at paras 390A-B, per Lord Hope of Craighead.

fairly broad-brush. Put shortly, there can be no single "right" answer to what rate should be set."[34]

46. In order to facilitate the negotiation of settlements and the presentation of cases in court Lord Irvine reached three conclusions. First, he would set a single rate to cover all cases. Secondly, this rate was to be set to the nearest half per cent., so that it would be consistent with the Ogden Tables,[35] easy to apply and reflect the variety of circumstances in which it would have to be applied over time. Thirdly, the rate should last for a reasonable period into the future (whilst not ruling out a change if there was a significant and established change in rates of return).

47. Lord Irvine also recognised a number of other factors. Claimants who have suffered severe injuries are not in the position of ordinary investors, and have a pressing need for a dependable source of income to meet their costs of future care, which means that it is unrealistic to require them to take even moderate risks when they invest their damages awards. In the light of this he adopted the approach taken by the House of Lords of determining the real rate of return obtainable by claimants through low-risk investment by reference to the gross redemption yields on ILGS. This led him to set the rate by reference to the average yields on ILGS over a three year period up to June 2001. This average at an assumed rate of inflation of 3% was 2.46%, giving a discount rate in the range 2.0–2.5%.

48. Lord Irvine did, however, note that Lord Lloyd of Berwick preferred a one year period to a three year average, which indicated a need for judgements to be made in determining the appropriate yield.

49. Lord Irvine also decided that it was appropriate to take a simple average of ILGS yields rather than an average weighted in accordance with the market value of each stock (this was not a point considered by the House of Lords). He indicated that a weighting approach was not relevant as the choice of ILGS portfolio which is necessary to ensure that the future financial needs of a claimant are adequately and promptly met does not

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[34] See Appendix A.1 (page 50).

[35] The tables used by parties to litigation to take into account actuarial factors in computing the quantum of damages. The first edition appeared in 1984; the latest (seventh) edition was published on 10 October 2011. The tables are prepared by the Government Actuary's Department with a multi-disciplinary group of actuaries (including the Government Actuary), lawyers, accountants and insurers, chaired by Robin de Wilde, QC. The tables provide an aid for those assessing the lump sum appropriate as compensation for a continuing future pecuniary loss or consequential expense, such as care costs, in personal injury and fatal accident cases. The tables provide factors known as multipliers which are used to assess the present capital values of future annual losses or expenses. The multipliers are based on projected future mortality rates from the 2004-based national population projections for the United Kingdom. As well as providing tables of multipliers, the publication provides explanatory notes as to how the tables should be used.

depend upon the prevailing market values of ILGS. He also concluded that it was proper to take an average over all ILGS rather than to exclude ILGS with less than five years to maturity. This was because in *Wells v Wells* it was assumed that a claimant would generally hold all his ILGS until redemption, and that in each year of loss a proportion of the capital would have to be used. He indicated that for these two assumptions to be consistent it would be necessary for the claimant to purchase ILGS which would mature in the short term, as otherwise they would have to sell a proportion of their ILGS prior to redemption in order to realise, in the short term, some of the capital value of their investment. He did, however, decide that it would be inappropriate to include the gross redemption yields of ILGS which are very near maturity as this is a nominal yield rather than a real yield (which adjusts for inflation). Instead he estimated the real yield by taking into account the expected annual inflation rate and the nominal yield.[36]

50. In addition, in deciding whether the rate should be rounded up or down, Lord Irvine took into account certain other factors relevant to the setting of a discount rate which was just as between claimants as a group and defendants as a group. First, he noted that the real rate of return to be expected from ILGS tended to be higher the lower the rate of inflation is assumed to be. Lord Irvine considered that inflation was likely to run below the figure of 3% built into the average gross redemption yield figure of 2.46%. This provided comfort that a discount rate set at 2.5% was reasonable. Secondly, he felt further supported in this conclusion by indications that the rate of return in respect of ILGS did not represent a pure and undistorted measure of the real rate of return which markets would afford in relation to investments with minimal risk. Thirdly, he noted that the Court of Protection,[37] which has specific responsibility to ensure that the financial needs of those for whose benefit it acts will be met, had continued to invest, on behalf of claimants, in multi-asset portfolios, including an equity element. Investment in this manner could, he thought, be expected to produce real rates of return well in excess of 2.5% and to be a sensible, low risk investment strategy, without undue exposure to risk in the equity markets. Fourthly, he considered that it was likely claimants with a large award of compensation, who sought investment advice and instructed their advisers as to the particular investment objectives which they needed to fulfil (as they could reasonably be expected to do) would not be advised to invest solely or even primarily in ILGS, but rather in a mixed portfolio, in which any investment risk would be managed so as to be very low. Taking this with the absence of evidence that any claimant had invested solely in ILGS he concluded that

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[36] This calculation uses the “Fisher identity”, which estimates the relationship between nominal and real interest rates under inflation.

[37] The Court of Protection is a specialist court for all issues relating to people who lack capacity to make specific decisions. The Court makes decisions and appoints deputies to make decisions in the best interests of those who lack capacity to do so.

setting the discount rate at 2.5% would not place an intolerable burden on claimants to take on excessive, that is moderate or above, risk in the equity markets, and would be a rate more likely to accord with real expectations of returns, particularly at the higher end of awards.

51. In setting the rate for Scotland at 2.5% in February 2002, Lord Irvine's counterpart, Jim Wallace MSP, took a similar approach.[38] Both Ministers therefore did not follow exactly the same approach as the House of Lords in *Wells v Wells*.[39]

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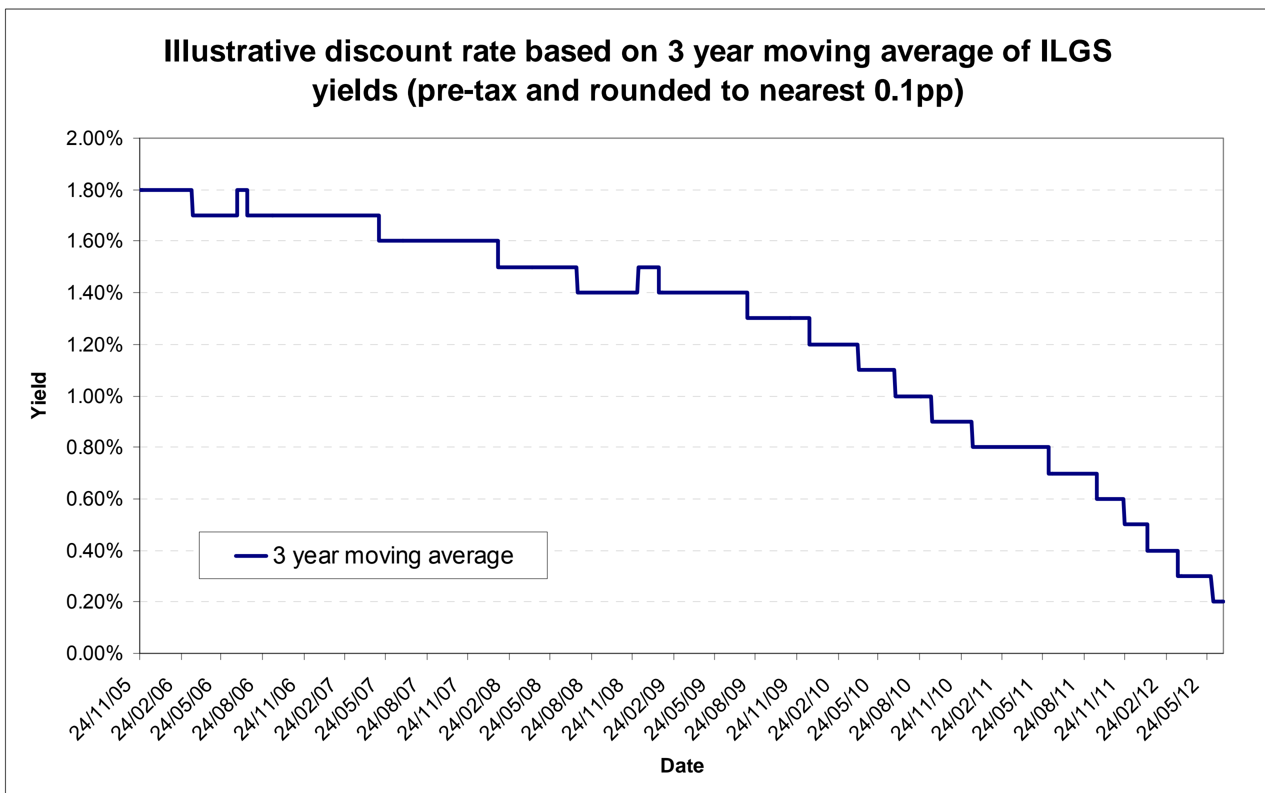
[38] See Appendix A.2 (page 56).

[39] See the comments of Lord Hope in the recent Privy Council case of *Simon v Helmot* [2012] UKPC 5 at paragraph 49.

Part 3 – The current consultation

52. In this Part of the paper we explain why the Lord Chancellor and his counterparts in Scotland and Northern Ireland have decided to review discount rate and the methodology by which it is set.

53. As we have explained the discount rate was largely set in 1998 and 2001/2002 by reference to the yield on ILGS. ILGS remains available as an investment but since 2001, for a variety of reasons, the three year average yield on ILGS has declined from 2.46% pre-tax, to about 0.2 pre-tax in mid-2012. The movement of the three year average yield since November 2005 is shown on the graph below.



54. This has led to concerns that the current prescribed rate may no longer be an accurate reflection of current returns on investment. If the discount rate is too high, claimants will be being under-compensated and may be encouraged to take greater investment risks than might be prudent to provide the level of income they require. If the rate is too low claimants will be over-compensated for their injuries.

55. In the light of this situation and their duty to ensure that the rate prescribed under section 1 of the 1996 Act is not inappropriate, the Lord Chancellor and his counterparts decided to review the rate. As required by the Damages Act 1996, they consulted the Government Actuary (GA) and, in addition, the Lord Chancellor consulted HM Treasury (HMT). The GA and HMT both advised that consideration should be given to

reviewing the methodology for calculating the discount rate. In Northern Ireland, the Department of Justice consulted the Department of Finance and Personnel, which concurred with the points made by GA and HMT.

56. The GA considered that averaging the ILGS yields of the last three years was likely to be misleading as an indicator of future returns because the return to investors (who hold their ILGS to maturity) will be the yield on the day they invest, not the yields available in the past.

57. The GA made a number of other points about the methodology used to set the current rate, which supported his view that the three year average could be a misleading indicator of the expected real returns on investment in government bonds over the period that compensation awards are intended to cover. First, the calculation of the real yield is dependent on the assumed inflation for the period between indexation and payment. This is more important for short dated bonds and those with an eight month indexation lag, which suggested to the GA that the shortest dated bonds should be excluded from the average. Secondly, the use of a simple average of all ILGS places a relatively high weighting on the yield of ILGS with short maturity dates given the payments are likely to be required over a longer period. A weighted average would place greater weight on yields on longer dated ILGS of which there are more in issue. Thirdly, the switch from RPI inflation to Consumer Price Index (CPI) inflation for the uprating and indexation of some benefits and pensions calls into doubt the reliance on real yields and real returns calculated with reference to RPI. Finally, the GA noted that deducting 15% from the award was likely to be an insufficient allowance for tax, especially for large awards.

58. Looking ahead the GA considered that the markets appeared to be more volatile at present than in the past and saw a number of factors that might reasonably be expected to have a material effect on bond yields in the next three years. These included the possibilities that despite ongoing demand from pension funds and insurers, yields on ILGS might rise, reflecting both the increases in supply of ILGS, and the impact of the switch to CPI on the demand for ILGS as a liability-matching asset. The GA considered that these factors argued for current rates to be used in setting the discount rate and then adjusting the rate as necessary, rather than trying to second guess the markets as to the future. Notwithstanding this, the GA did consider that the expected future increase in yields on longer dated bonds (the forward rates currently available in the market) should be taken into account.

59. HMT concurred that using a backward-looking three year average of yields does not necessarily provide an accurate indication of the current returns available, and gives rise to potential over- or under-compensation depending on the part of the economic cycle during which the compensation payments are made. HMT also noted that issuance of ILGS has increased in recent years with the market becoming deeper and more liquid, and that a simple average of real yields on index-linked gilts overlooks the relative skew of the ILGS portfolio towards longer

maturities. HMT noted further that index-linked gilts issued since April 2005 have a three-month indexation lag rather than an eight-month lag as was previously the case[40] and that the Government has recently consulted on the case for issuing index-linked gilts linked to the CPI.[41] The Government has subsequently ruled out issuing CPI-linked gilts in 2012-13 but will keep the case for issuance under review in the medium term.[42] Together these developments were considered to support the case for reviewing the methodology used to calculate the discount rate.

60. In the light of these views, the Lord Chancellor and his counterparts have decided that it is appropriate to review the methodology to be applied in setting the discount rate and as part of that review to issue this consultation paper.

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[40] As with all index-linked bonds, there is a time lag between the collection of prices data, the publication of the inflation index and the indexation of the bond. From their introduction in 1981, index-linked gilts had an eight-month indexation lag (between the month of collection of prices data and the month of indexation of the bond). This was so that the amount of the next coupon was known at the start of each six-month interest accrual period. However, in 2005 the UK Debt management Office announced that all new issues of index-linked gilts would use a three-month indexation lag, and several gilts have now been issued on that basis.

[41] http://www.dmo.gov.uk/index.aspx?page=Gilts/consultation_papers

[42] http://www.dmo.gov.uk/documentview.aspx?docName=publications/giltsmarket/consultationpapers/cons20111129.pdf

Part 4 – Options

Introduction

61. In this Part of the paper we describe and seek views on how the discount rate should be set. We first explain our general approach and then consider the options in detail.

General approach

62. Section 1 of the Damages Act 1996 specifies that in determining the return to be expected from the investment of a lump sum award of damages for future pecuniary loss in an action for personal injury, the court must take account of the rate of return prescribed by the Lord Chancellor and his counterparts in Scotland and Northern Ireland. The discount rate prescribed under section 1 is therefore set by determining the rate of return that is expected to be achieved in those circumstances.

63. How though is the appropriate rate of return to be determined? Rates of return on investments vary widely as do the circumstances of claimants and the investments that they make. There is therefore unlikely to be a single 'right' rate, but the overriding purpose of the exercise is to set the discount rate as accurately as can be achieved so that under- or over-compensation by reason of the accelerated payment of the future losses is avoided as far as possible.

64. Theoretically, the purest solution would be to provide for individual discount rates tailored to individual cases, but this would be very burdensome. Whilst general discount rates will only approximate with varying degrees of accuracy to the circumstances of claimants, they have the merit of encouraging the settlement of disputes and the simplification of litigation, saving time and money. A general rate of return is therefore required. To achieve this, assumptions have to be made about the nature of the investor and the investments that he or she makes. These assumptions create an inherent degree of approximation between the factors by reference to which the discount rate is set and the factors that will actually apply to individual claimant investors. A key factor will be the degree of investment risk that the investor is assumed to be willing to take.

65. Investors' risks consist of various elements. The two principal types we are concerned with for our purposes are market risks and 'mismatch risk'. Market risks comprise of risks arising out of volatility or uncertainty in the price or income of investments (for example, a bond issuer defaults). These risks affect all investments and are reflected to varying degrees of accuracy in the price that the investment commands. 'Mismatch risks' are related to what the specific investor wants the money for. They are the risk that the result of making the investments does not match the individual investor's objective in making the investments. This is illustrated in the box below.

Example – market and mismatch risks.

For simplicity consider a claimant who has care costs to meet in a lump sum in 10 years time. This lump sum would be £10,000 pounds if the defendant had to pay it now. It will increase in line with care cost inflation over the ten years. The claimant could invest his or her award in a number of ways:

1. In a portfolio of equities (i.e. in the stock market). There is a **market risk** that equity prices will be low in ten years time and the claimant will not be able to pay £10,000 plus care cost inflation.
2. In a portfolio of fixed interest corporate bonds (with no index-linking).
   a. There is a **market risk** that the company issuing the bond defaults.
   b. There is also a **mismatch risk** if inflation is higher than expected. This would erode the spending power of the bond income.
3. In a portfolio of ILGS.
   a. There is very little **market risk**.
   b. There is still a **mismatch risk** if there is not a bond that pays out in exactly ten years time. If the claimant buys a 5 year bond, there is the risk that bond prices will rise and so the claimant will not be able to get such a high return for the second 5 years. If, on the other hand the claimant buys a 20 year bond, there is the risk that bond prices will fall and so they will not get enough money back when the claimant sells in 10 years time.
   c. There is also a **mismatch risk** if care cost inflation is higher than RPI inflation to which ILGS is linked. The claimant would then have a shortfall to meet.

Note that in reality a claimant investor would need to receive a stream of payments from a portfolio of assets but the same principles would apply.

66. In so far as an individual investor's level of mismatch risk differs from that of investors generally, the mismatch is unlikely to be reflected in the price. One form of mismatch risk could be the potential difference between the investments by reference to which the discount rate is set and the investments actually available in the market when the claimant investor comes to invest. This is largely the result of the simplifying assumptions made in setting the methodology used to derive a discount rate, and is likely to apply to all generic rates. Another form of mismatch risk is the difference between the return on the investment assumed to be made for the purposes of setting the discount rate and the return actually needed to meet the real needs of the individual claimant as they arise.

67. The existence of these risks means that any investments, including investment in ILGS, will only be risk-free (in the sense of avoiding the

possibility of running out of money to pay for future requirements) under certain conditions.[43]

68. The person setting the discount rate must therefore decide what degree of risk should be assumed for the purposes of defining the investments that are to be assumed to be made by the hypothetical claimant investor. In this, the person setting the rate will be guided by the decision of the House of Lords in *Wells v Wells*.[44] The prospective investor of the lump sum award of damages will therefore be assumed to be a person who requires the investment to produce the money required to meet future costs and losses as they arise. In other words, the claimant will be a low risk investor and the discount rate should accurately reflect the rate of return to be expected from the investment that such an investor would make. This investment must clearly aim to protect the investor against the effect of inflation on the future costs and losses.

69. This approach led to the discount rate being prescribed by reference to the rate of return on ILGS in 2001 (in England, Wales and Northern Ireland) and 2002 (in Scotland). However, as we have explained, the methodology used at that time has been criticised. Our first option therefore invites views on whether these criticisms could be overcome whilst still retaining an ILGS-based approach.

70. ILGS is a very secure investment. If held to redemption it will produce the expected return protected against inflation as measured by the RPI. In that scenario market risk is negligible. Nonetheless, investing in ILGS (or any other instrument) will not eliminate the mismatch risk derived from the simplifying assumptions used in the setting of the rate. For example, the investments on which the calculation of the discount rate is based may not be available in the market at the time the claimant comes to invest or may be only partially relevant to the actual claimant's needs. Thus, if the discount rate is set by reference to returns on the whole range of ILGS, some of which have redemption dates beyond 2050, that rate is very unlikely exactly to match the returns that are actually relevant to a claimant investor whose award is calculated to be exhausted by 2040.

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[43] These conditions include: A. The investor knows his or her future cash requirements (net of RPI). For example, if the payments are needed for life, the investor would need to know how long they will live. B. The future costs of the claimant will increase with RPI. For example, the cost of care may increase at a different rate to general inflation. C. The investor is able to construct a portfolio of ILGS that will provide the required income if held to maturity. For example, there may not be bonds with a long enough maturity for all investors. D. The calculation of the discount rate is done at the moment the claimant invests the money, otherwise changes in market conditions may mean that claimant does not get the anticipated returns.

[44] [1999] 1 AC 345.

71. Nor will investing in ILGS necessarily eliminate another mismatch risk that affects investments generally. This is the risk that the claimant investor's actual costs will differ from his or her expected costs. If the actual costs increase at a rate greater than the RPI then investment in ILGS will not protect against the excess increase. The degree to which this risk will affect individual claimants will vary from case to case depending upon the nature of the investments and costs in question. However, it is clear that there is no necessary reason why claimant investors' costs should exactly follow the RPI.

72. It follows that investment in ILGS may carry a similar level of mismatch risk of this kind to other market investments. This risk is, however, not likely to be reflected in the price of ILGS, which is largely determined by the marginal investor, typically, pensions funds and life assurance companies, who invest in ILGS to meet fairly predictable large scale long-term liabilities directly linked to the RPI. ILGS may therefore match the liabilities of such investors very well (and they will pay a price to reflect that) but be a relatively expensive way for personal injury claimants to buy protection against cost inflation.

73. In these circumstances it could be more efficient for claimants to invest in assets with a higher return if such investments have a similar level of risk relative to claimant needs as ILGS.

74. These considerations raise the possibility – and it is no more than a possibility – that assuming a pure ILGS portfolio might not be the only appropriate way in which to set the discount rate because a similar low level of risk might be obtainable by making another form of investment. We have therefore included a second option for consideration. In this option the rate of return would be measured by reference to an appropriate mixed portfolio of low risk investments.

75. In considering these two options, we will be looking for the methodology that produces the most accurate discount rate under section 1 of the Damages Act 1996. We expect that as previously the rate identified will be rounded so that it can be readily used in conjunction with the Ogden Tables and that whilst the rate will have to be changed if circumstances so require, it should not require changing too frequently.

Possible Methodologies

Options 1 – ILGS based approach applied to current data

76. Option 1 is based on the use of ILGS as the measure of the real rate of return. It retains the use of ILGS as the basis of the portfolio but opens for discussion every other detail of how a methodology constructed around ILGS might work. We consider several of the principal variables in turn.

Holding ILGS stock to redemption

77. A key element underpinning the setting of the rate previously was that the investment was assumed to be held until maturity. This was intended to protect the claimant from the volatility of the market. However, such an investment strategy may not be realisable in practice.

Question 1: Do you agree that the claimant should be assumed to hold all ILGS until redemption? If not, what alternative assumption would you make? Please give reasons.

Estimating the real rate of return – historic, current, or anticipated data

78. The discount rate was last set on the assumption that a proportion of capital would be used in each year of loss, so that it was proper to take an average over all ILGS rather than to exclude ILGS with less than 5 years to maturity, as had been done by the House of Lords in 1998.

79. The calculation for the current discount rate was therefore based on a simple (non-weighted) three year average of ILGS real yields. This implies that the investment return is assumed to be broadly equal to the return implied by the average real yields over the three years prior to the calculation date.

80. Using such an average of real yields is one way to minimise the impact of volatility by ensuring that the discount rate is based on market conditions over a period of time, rather than solely on market conditions when the calculation is made. However, as we have described,[45] this approach has been criticised and in theory there are a large number of other models and methods available which could potentially be used to forecast future investment returns. It can, for example, be argued that averaging past performance to remove volatility is only useful if past average yields are a good guide to future performance. In this respect, standard financial economics would suggest that current market conditions, whether current yields or current implied yields on investing in the future (known as the forward rates) are the best predictor of future returns, which is particularly relevant to achieving an accurate discount rate.

81. When the discount rate was set in the past, historic data from the preceding three years were used. Lord Lloyd, however, considered that one year would have sufficed. Given the variation in market conditions over time, the choice of the length of period may produce quite different results.

Question 2: By reference to what ILGS yields should the discount rate be set? Please give reasons.

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[45] Para 56–59.

What ILGS should be included? Should the average be simple or weighted?

82. As we have mentioned, although most recently an average of all ILGS stock was taken (rather than excluding stock with less than five years to maturity as had been done in 1998), it was decided that it would be inappropriate to include the gross redemption yields of near maturity ILGS.[46]

83. There are arguments that using a simple average in this way gives too much weight to short term gilts and that short-dated gilts of less than five years should, for example, be excluded. Another method would be to weight the average yields by maturity of the gilts and/or by the proportion of the outstanding index-linked gilt portfolio accounted for by a particular gilt. This would mean that the yields from longer dated bonds, which represent a larger proportion of the index-linked gilt portfolio, and which are therefore more representative of the index-linked gilt investment options available, would be given more weight. However, if the majority of awards are for shorter periods, giving a weighting to longer-dated bonds may itself give rise to a distortion and there may be an argument for excluding longer-dated gilts.

84. In relation to the issue of near maturity ILGS, there are two designs of ILGS – 3-month indexation lag and 8-month indexation lag. ILGS in the 2–6 weeks (for 3-month lag) or approximately seven months (for 8-month lag) before their redemption date (more specifically, from the day that the RPI which fixes the nominal value of the redemption payment is published) become in effect conventional gilts (as their future cash flows are known in nominal terms). They are therefore different in nature from longer-dated ILGS as their cash flows are no longer adjusted for inflation during the lag period. This is why Lord Irvine made a special allowance for them in his calculation of the average yield in 2001.

Question 3: What range of ILGS yields should the discount rate be based on and what calculation should be applied to them? Please give reasons.

Taking inflation into account

85. Inflation and deflation lie at the root of the requirement for a discount rate and give rise to a number of issues.

86. There is the risk that although ILGS will provide security about the level of income to be received by the claimant, the inflation applicable to the expenses to be paid by the claimant may exceed the rate of inflation recorded by the RPI, so that his or her income will fail to keep pace with outgoings. It is therefore for consideration whether some other index more specifically related to care costs should be used. In the context of periodical payments, for example, a range of potential methods of

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[46] See paragraph 49 above.

indexation of earnings were considered by the Court of Appeal in *Thompstone v Tameside and Glossop Acute Services NHS Trust and others*.[47]

Question 4: should any allowance be made for potential differences between RPI inflation and health care costs inflation? Please give reasons.

Rounding

87. The calculations we have discussed will provide a mathematical answer. However, it would be in the interests of simplicity for the effect of the rate to be readily calculable in individual cases. In setting the current discount rate and deciding to round the three year average of 2.46% upwards to 2.5% rather than down to 2.0%, certain factors were taken into account.[48] Briefly, these were the level of inflation; the alleged distortion present at that time in the ILGS market; the fact that following the judgment in *Wells v Wells* the Court of Protection had continued to advise claimants to invest in multi-asset portfolios; and the likelihood that independent financial advisers would advise investment in a mixed portfolio rather than solely or even primarily in ILGS.

88. The underlying reason for restricting the rounding to half per cent points is pragmatic. It enables the discount rate to be readily used with the actuarial tables used to calculate care costs. We are not aware of any problems with this approach. The direction of the rounding may however be influenced by a variety of factors, which may vary in importance from time to time. We would be grateful for views as to whether the rounding should ever be beyond the range of the half- percentage points above and below the arithmetical rate. For example, if the yield is 2.01% should the rate only be 2.00% or 2.5%? Might it not be equally sensible to have the choice of 1.5%?

Question 5: What considerations should be applied to the rounding up or down of the discount rate? Please explain your reasons.

Question 6: Should the rounding of the discount rate be restricted to one half per cent? If not, what degree of rounding would be appropriate? Please give reasons.

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[47] [2008] 1 WLR 2007. The court considered three alternatives to the RPI. Each of which was an official measure of earnings published by the Office for National Statistics: Average earnings index; Annual survey of hours and earnings; and the Median and annual survey of hours and earnings (which was adopted by the court).

[48] See Appendix A.1 (Page 50).

Tax and investment expenses

89. The discount rate should be set at a level such that damages awarded should compensate a claimant appropriately for their losses (avoiding systemic over-compensation or under-compensation). The House of Lords in *Wells v Wells* commented that the discount rate should take into account standard rate tax and that higher or unusual rates of tax could be the subject of an appropriate adjustment in individual cases.[49] Is this still an appropriate conclusion?

90. Similarly, should any allowance be made to compensate claimants for future investment expenses related to managing their asset portfolio? The kind of costs that we have in mind relate to the setting up and management of investment portfolios. The more complicated the choice of investments within the portfolio used to calculate the discount rate, the greater the investment costs would be likely to be for a claimant replicating that approach in practice. As few claimants would be likely to have the expertise to manage their own portfolio, investment costs of a certain order may well be unavoidable for any long term investment, whether mixed or ILGS only. In some, but not all, cases investment expenses are allowed as a separate head of claim. It is for consideration whether an allowance for such expenses should be included in the calculation of the discount rate.

Question 7: What allowance should be made for investment expenses and tax? Please give reasons.

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[49] Lord Hope said: The impact of higher rate tax on particular awards in exceptional cases should be dealt with in the manner described by Lord Oliver of Aylmerton in Hodgson v Trapp [1989] 1 AC 807, 835D-E: "Both in *Cookson v. Knowles* [1979] A.C. 556 and in *Lim's* case [1980] A.C. 174 this House was prepared to envisage that there might be very exceptional cases, where it could be positively shown by evidence that justice required it, in which special allowance might have to be made for inflation and, inferentially, for tax. Such cases are not, I suppose, impossible, although for my part I do not find it easy to envisage circumstances in which evidence could satisfactorily establish that which is inherently uncertain. It would, I think, be extremely undesirable that trials of personal injury cases should be encumbered with evidence from actuaries and accountants directed to demonstrating the unprovable as scientific fact for the purposes of an exercise which is, in its very nature, incapable of being scientific. Moreover, I cannot think that such evidence would in the end be of any real assistance to the trial judge in making his assessment. Tax is merely one of the many imponderables that are taken care of in the conventional method of assessing damages. There may, I suppose, be cases—although, again, I cannot for my part readily imagine one arising in an exercise in its nature imprecise—where the considerations pointing to the selection of one of two possible multipliers are so finely balanced that the future incidence of taxation may be taken into account as one, but only one, of the factors which might properly tip the balance in favour of selecting the higher rate rather than the lower, but the course sanctioned in *Thomas v. Wignall* [1987] Q.B. 1098 of making a specific addition on account of this factor alone is, in my judgment, as incorrect as would be a specific addition to cover the risk of future inflation."

Option 2 – mixed portfolio applied to current data

91. Option 1 assumes the hypothetical claimant will only invest in ILGS. However, if the hypothetical claimant who invests in ILGS is exposed to some degree of risk, it is reasonable to consider whether he or she might consider other types of investment with a similar risk, particularly if the yield from such investments can reasonably be expected to be greater than the yield from ILGS. Option 2 therefore posits the possibility that the hypothetical claimant might invest in some other adequately secure way.

92. We have not reached any final conclusion as to whether ILGS remains the best measure of the real rate of return for setting the discount rate or whether there is in practice a mixed portfolio of assets that would meet the required standard of fair compensation, but for the purposes of this consultation have identified three possible types of assumed asset base (or portfolio) other than ILGS that might perhaps be considered adequately "low risk". These investments might be combined with one another and with ILGS. There may, however, be other possibilities. The key questions are whether the mixed portfolio of investments would satisfy the low level of risk identified by the decision of the House of Lords in *Wells v Wells* and how accurately such a portfolio would compensate claimants.

93. The possible alternatives that we have identified for consideration are 'Mixed investment 0–35% shares)', 'Sterling Fixed Interest' and 'Money Market'. These portfolio type descriptions are taken from the ABI's classification.[50] This defines them in the following terms:

Mixed Investment 0%–35% Shares

- Funds should hold a range of different investments.
- Maximum of 35% total shares (including Preference Shares, Permanent Interest Bearing Shares and Convertibles).
- No minimum share requirement but managers' stated intention retains the right to invest in shares.
- Minimum of 85% Sterling based investments (including fixed interest hedged back to Sterling).
- Fixed interest defined as Government Sovereign Bonds and Corporate Bonds

[50] http://www.abi.org.uk/Life_Funds/Sector_Parameters.aspx

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Sterling Fixed Interest

- Funds which invest at least 80% of their assets in Sterling-denominated (or hedged back to Sterling) broad investment grade fixed interest securities.
- Fixed Interest securities defined as Government sovereign bonds, local authority bonds, supranational bonds and corporate bonds. Preference shares, permanent interest bearing shares (PIBs) and convertibles are not treated as broad investment grade fixed interest investments.

Additional notes:

1. Investment grade is established by the average of the ratings determined by Standard & Poor's, Moody's and Fitch. Broad investment grade is defined as (or equivalent to) BBB minus or above as measured by Standard & Poor's and by Fitch and Baa3 or above as measured by Moody's.
2. Flags include; multi-manager, socially responsible, duration-long (life funds only) and duration-short funds

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Money Market

- Funds which invest at least 95% of their assets in sterling (or hedged back to sterling) money market instruments.
- Money market instruments are defined as cash and near cash, such as bank deposits, certificates of deposit, and fixed interest securities or floating rate notes

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94. The principal risks for an investor of this type include: A. the risk that the capital values of the investment fall so that the investor has to sell a larger proportion of their fund to maintain the same income (depleting the fund more quickly than planned and leaving a shortfall); and B. the risk that the overall growth of the investment may not be sufficient for the recipient's needs. Amongst other things the growth may not keep up with (RPI) inflation. Again this will reduce the income that the recipient will receive from the fund.

95. For the purpose of comparing the relative risks of portfolios within option 2 with the ILGS only based investment of option 1, the following table gives an indication of some possible levels of extra return relative to ILGS and the market risks that investors would have to bear. The risks and returns are considered net of RPI inflation. As the categories are only intended to be relative we have not provided more detailed definitions. These estimates of risk are based on a broad assessment of relative risk for the purposes of this consultation paper and are not intended to provide any form of investment advice.

Portfolio Type	Assumed future returns	A. Risk to Capital Value	B. Risk of insufficient investment growth
Mixed investment 0–35% shares	ILGS + 1%	Moderate	Slight
Sterling fixed interest	ILGS + 0.75%	Slight	Moderate
Money market	ILGS +0.5%	Negligible	Slight
100% ILGS	ILGS	Slight	Slight
100% ILGS held to redemption	ILGS	Nil[51]	Nil

96. Looking at this table it would appear that the final option (100% ILGS held to redemption) is practically risk free from the point of view of providing a return at or above the inflation outturn, with minimal risk to capital value. However, some risks are unavoidable because for an investor of the kind we are considering it may not be possible to construct a portfolio of ILGS held to maturity and inflation measured by RPI may not match the inflation applicable to the costs actually to be borne. The level of mismatch risk within each portfolio type will vary according to the assumptions chosen to set the rate and the individual circumstances of the claimant in question.[52]

97. Assuming that at least one such portfolio provides a feasible approach, we invite views on the methodology to be followed in setting a discount rate by reference to an approach within option 2. There are potentially a great number of variables but in general terms the issues are likely to be similar to those raised in relation to option 1. We have therefore not repeated the discussion here (see paragraphs 78–90), but would be grateful for the views of consultees on the following issues.

Question 8: Do you agree that setting the discount rate on the basis of the expected return from a mixed portfolio of assets is in principle consistent with the decision of the House of Lords in Wells v Wells? Please give reasons.

Question 9: If option 2 is adopted, what should the mixed portfolio of assets on which the calculation of the discount rate is to be based contain? Please indicate the type and proportions of assets to be included and give reasons for your choice.

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[51] Of course, if there is deflation over the life of an ILG then the capital repaid at maturity will be less (in nominal terms) than the capital invested.

[52] See paragraphs 65 et seq.

Question 10: Assuming the return on the portfolio you have identified is broadly to be the basis on which the discount rate is to be calculated, what range of data should be included in the calculation? Please consider whether the data should be historic and whether any averages should be simple or weighted

Question 11: Should any other factors, such as allowances for inflation, tax or investment expenses, be taken into account and if so, how? Please give reasons.

Discount rate methodology – what approach should be adopted?

98. Having considered each option in detail we now seek views on which overall approach you prefer.

Question 12: Should the Lord Chancellor and his counterparts in Scotland and Northern Ireland set the discount rate under section 1 of the Damages Act 1996:

a. by retaining an ILGS based approach but changing some or all of the detailed criteria used (option 1);

b. by moving away from an ILGS based approach to a mixed portfolio of investments based approach (option 2); or

c. by reference to some other approach? If so please give details.

Please give reasons for your choice.

A single rate

99. We have assumed so far that there will only be one discount rate. This will clearly be simpler to apply than a multiplicity of rates, where a decision has to be made as to which rate should be applied in an individual case. However, section 1(3) of the Damages Act 1996 allows for different rates to be set for different classes of case, whilst section 1(2) makes clear that the court can take a different rate of return into account if one of the parties shows that this is more appropriate than the general discount rate. The greater flexibility of two or more rates might help produce greater overall accuracy in the calculation of awards of damages as a range rates would better match a greater range of circumstances. Since 2001/2002, however, there has only been one prescribed rate. We are not aware that this has caused any widespread problems and assume that the power to disregard the prescribed rate provides adequate safeguard for cases where it is not appropriate. Nonetheless, taking a broad brush approach must increase the chances that the investment assumptions that would be applied in the case of the actual claimant are not matched by those used in the setting of the rate. This would increase the chance that the rate is not as appropriate for the case in question. Despite the inevitable difficulties that would affect borderline cases, it is for consideration whether it might be preferable to have more than one rate.

Question 13: Do you agree that one prescribed discount rate is sufficient? If not, please specify what classes of cases should be affected by different rates and what the differences should be in the ways that the different rates are to be set. Please give reasons.

Suggested discount rate or rates

100. Whilst the setting of the rate is a matter for the Lord Chancellor alone in England and Wales, and for the Scottish Ministers alone and the Department of Justice in Northern Ireland alone in their respective jurisdictions, we would be interested to know, following your answers to the above questions, what you think that the discount rate or rates should now be.

Question 14: what discount rate or rates do you consider would be appropriate now? Please indicate the basis for your decision.

Impact assessment

101. The effect of a change in the discount rate will only become apparent when the rate has been changed. The size of the rate change may however be influenced by the methodology chosen as a result of this consultation. We have therefore prepared an impact assessment in relation to the differences between the two different methodologies that we have set out as options in this paper. The impact assessment is at Appendix B. We intend to prepare a further impact assessment once a methodology has been chosen and applied.

102. The impact assessment assumes that in general terms the discount rate will affect the investment choices of claimants. This seems very likely to be true as the effect of even relatively small changes in the rate can significantly affect the size of the award to the individuals concerned. The assessment also assumes that claimants will react homogenously to changes in the level of the rate. This irons out the likelihood that in reality claimants will probably react in a range of ways, both more and less adventurous. If the rate is too high claimants will need to chase higher returns in the market to achieve the result that the discount rate expected them to achieve; conversely, if the rate is too low, claimants will be able to achieve the result required with much less risk. The point of choosing a methodology is to provide a means of identifying where the middle ground between too high and too low falls. Within that middle ground lies the appropriate discount rate.

103. To help establish where the boundaries of these different categories lie, we need to have evidence of what happens in reality and what perceptions people have of their own investment behaviour and that of others. Do claimants ever invest only in ILGS? Did they do so in the past? What drives or drive these investment decisions? We hope that the response to the consultation will provide us with a greater understanding of these matters.

104. In preparing the impact assessment we have identified that in addition to affecting the quantum of lump sum awards of damages for personal injury, changes to the discount rate may have consequences for the level of insurance premiums payable generally.

105. These consequences are outside the scope of the matters that the Lord Chancellor and his counterparts in Scotland and Northern Ireland may consider in deciding what the discount rate is to be or what methodology he is to use in setting it. In particular, as set out above, consequences for defendants do not bear on the question of what is a fair approach to compensation. The consequences identified by the impact assessment follow inevitably from the fulfilment of the duty to set a rate under section 1 of the Damages Act 1996 that satisfies the principle of full compensation. The sums involved may increase or decrease depending on whether the rate is increased or decreased. The duty in relation to the present review is to ensure that the rate set is appropriate under section 1.

Question 15: do you agree with the impact assessment at Appendix B? If not, please explain why.

106. There is no obligation on a claimant to invest a lump sum in the same portfolio as that used to set the discount rate. However, it seems reasonable that the assumptions made about what it is reasonable to include in the discount rate portfolio in order to provide the fairest possible compensation should be influenced by the types of investments that claimants are prepared to make in the real world when disposing of their lump sums. We would welcome evidence as to the typical content of the portfolios constructed with lump sum payments of personal injury damages and evidence of the periods over which they are expected to provide an appropriate income for the claimant. It would also be helpful to know whether those investments have in fact delivered the expected income over the required period.

107. We have indicated the possibility that investing in ILGS alone may be a relatively expensive way for claimants to obtain protection against future cost inflation. We would welcome evidence against which this can be tested.

Question 16: please provide evidence of the investments typically made by claimants with their lump sums and the expected and actual duration of awards of damages for personal injuries.

Question 17: Please indicate whether you consider that these investments carry the appropriate degree of risk for a personal injury claimant reliant on the money to be produced by the award.

Question 18: do you consider that investing in ILGS alone is relatively a less cost-effective way to protect claimants against future cost inflation than investing in a low risk mixed portfolio of investments? Please give evidence to support your conclusion.

Small Firms

108. As the discount rate will affect the sums payable in damages by some small firms liable for causing personal injuries, we have given careful consideration to whether the choice of the method by which the discount rate will be set might affect small firms. There could clearly be an indirect effect as the method of setting the rate may affect the level at which the rate is set. However, neither the rate nor the method by which it is set regulates the activity of small firms. Nor will they affect the operations or performance of small firms or affect them differently from other businesses. This is because the discount rate is applied by the court to its quantification of an established legal liability in personal injury cases. The application of the rate allows the court to take account of the accelerated payment inherent in the lump sum payments of damages, thereby preventing under- or over-compensation. This precludes any alternative approach or exemptions being applied in cases involving small firms, because there are no grounds on which a small firm should be required to pay the claimant more or less than the full compensation to which the claimant is legally entitled.

109. Small firms, other than sole-traders without employees, will not make personal injury claims. Even in the case of the sole-trader it is the individual who is injured and who is making the claim rather than that person in a business capacity, notwithstanding that the future losses claimed may relate to the prospective profits of the business lost through injury.

110. Small firms are vital to the economy and it is important that the effects on them of legislation are properly understood. We would therefore welcome views on any ways in which the choice of the method of setting the discount rate may affect small firms.

Question 19: Do you agree that the choice of the method of setting the discount rate will not have any direct effect on small firms? If not, please give details.

Question 20: Do you agree that the discount rate must apply in cases involving small firms in the same way that it does in other cases? If not, please give details.

Equality impact assessment

111. We have so far not identified any ways in which the method to be chosen for the setting of a single discount rate under section 1 of the Damages Act 1996 will impact positively or negatively on different groups of people with protected characteristics: (disability, race, sex, gender reassignment, age, marriage and civil partnership, religion and belief, pregnancy and maternity, and sexual orientation). However, in the context of personal injury claims, factors such as age and sex may, for example, have a bearing on the duration of awards. This may mean that some groups may possibly be differently affected by the choice of one method rather than

another – or by the setting of single or multiple rates. To help us consider this we would also welcome evidence of any ways in which the current discount rate affects people with these different protected characteristics and any views as to how the choice of methodology might also do so.

112. The Department of Justice, Northern Ireland has not so far identified any ways in which the method to be chosen for the setting of a discount rate under section 1 of the Damages Act 1996 will impact on equality of opportunity and /or good relations in relation to the categories protected under section 75 of the Northern Ireland Act 1998 (religious belief, political opinion, racial group, age, marital/civil partnership status, sexual orientation, sex, disability and persons with dependants). However the Department welcomes views on the equality screening available at Appendix D and also evidence of any ways in which the current discount rate affects people in the protected categories and views as to how the choice of methodology might also do so.

Question 21: do you agree with the equality impact assessment at Appendix C? If not, please explain why.

Question 22: do you agree with the equality screening at Appendix D respectively? If not, please explain why.

Question 23: please provide evidence of any ways in which the current discount rate affects people with different protected equality characteristics (see paragraphs 111–112).

Question 24: do you consider that the choice of how the discount rate should be set will affect people with protected equality characteristics? (see paragraphs 111–112) If so, please give details.

Other approaches and issues

113. We have considered a wide range of issues relating to the method of setting the discount rate under section 1 of the Damages Act 1996. If, however, there are issues that have not been raised on this subject but which you think should be drawn to our attention we would be grateful for your comments.

Question 25: Are there any other comments you wish to make on how the discount rate should be set?

Part 5 – Questionnaire

114. In this part we list the questions asked in the remainder of the paper. In providing your responses to these questions, it would be helpful if you could include any analysis or evidence you have to support your responses, drawing on experience of other sectors or countries as appropriate.

115. We would welcome responses to the following questions set out in this consultation paper either generally or specifically in relation to one or more of the jurisdictions in the United Kingdom.

Option 1 – ILGS based approach

Question 1: Do you agree that the claimant should be assumed to hold all ILGS until redemption? If not, what alternative assumption would you make? Please give reasons.

Question 2: By reference to what ILGS yields should the discount rate be set? Please give reasons.

Question 3: What range of ILGS yields should the discount rate be based on and what calculation should be applied to them? Please give reasons.

Question 4: should any allowance be made for potential differences between RPI inflation and health care costs inflation? Please give reasons.

Question 5: What considerations should be applied to the rounding up or down of the discount rate? Please explain your reasons.

Question 6: Should the rounding of the discount rate be restricted to one half per cent? If not, what degree of rounding would be appropriate? Please give reasons.

Question 7: What allowance should be made for investment expenses and tax? Please give reasons.

Option 2 – mixed portfolio applied to current data

Question 8: Do you agree that setting the discount rate on the basis of the expected return from a mixed portfolio of assets is in principle consistent with the decision of the House of Lords in *Wells v Wells*? Please give reasons.

Question 9: If option 2 is adopted, what should the mixed portfolio of assets on which the calculation of the discount rate is to be based contain? Please indicate the type and proportions of assets to be included and give reasons for your choice.

Question 10: Assuming the return on the portfolio you have identified is broadly to be the basis on which the discount rate is to be calculated, what range of data should be included in the calculation? Please consider whether the data should be historic and whether any averages should be simple or weighted

Question 11: Should any other factors, such as allowances for inflation, tax or investment expenses, be taken into account and if so, how? Please give reasons.

Discount rate methodology – what approach should be adopted?

Question 12: Should the Lord Chancellor and his counterparts in Scotland and Northern Ireland set the discount rate under section 1 of the Damages Act 1996:

a. by retaining an ILGS based approach but changing some or all of the detailed criteria used (option 1);

b. by moving away from an ILGS based approach to a mixed portfolio of investments based approach (option 2); or

c. by reference to some other approach? If so please give details.

Please give reasons for your choice.

A single rate

Question 13: Do you agree that one prescribed discount rate is sufficient? If not, please specify what classes of cases should be affected by different rates and what the differences should be in the ways that the different rates are to be set. Please give reasons.

Suggested discount rate or rates

Question 14: what discount rate or rates do you consider would be appropriate now? Please indicate the basis for your decision.

Impact assessment

Question 15: do you agree with the impact assessment at Appendix B? If not, please explain why.

Question 16: please provide evidence of the investments typically made by claimants with their lump sums and the expected and actual duration of awards of damages for personal injuries.

Question 17: Please indicate whether you consider that these investments carry the appropriate degree of risk for a personal injury claimant reliant on the money to be produced by the award.

Question 18: do you consider that investing in ILGS alone is relatively a less cost-effective way to protect claimants against future cost inflation than investing in a low risk mixed portfolio of investments? Please give evidence to support your conclusion.

Small Firms

Question 19: Do you agree that the choice of the method of setting the discount rate will not have any direct effect on small firms? If not, please give details.

Question 20: Do you agree that the discount rate must apply in cases involving small firms in the same way that it does in other cases? If not, please give details.

Equality impact assessment

Question 21: do you agree with the equality impact assessment at Appendix C? If not, please explain why.

Question 22: do you agree with the equality screening at Appendix D? If not, please explain why.

Question 23: please provide evidence of any ways in which the current discount rate affects people with different protected equality characteristics (see paragraphs 111–112).

Question 24: do you consider that the choice of how the discount rate should be set will affect people with protected equality characteristics? (see paragraphs 111–112) If so, please give details.

Other approaches and issues

Question 25: Are there any other comments you wish to make on how the discount rate should be set?

Thank you for participating in this consultation exercise.

About you

Please use this section to tell us about yourself

Full name	
Job title	
Capacity in which you are responding to this consultation exercise (select all which apply)	Legal representative: ☐ claimant/plaintiff/pursuer ☐ defendant/d efender ☐ Insurer ☐ Judiciary ☐ Financial institution ☐ Academic ☐ Public sector body ☐ Business ☐ Equality group ☐ Member of public ☐ Other [please state]
Date	
Company name/organisation (if applicable):	
Address	
Postcode	
If you would like us to acknowledge receipt of your response, please tick this 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 23 October 2012 to:

Damages discount rate consultation
Ministry of Justice
Criminal Law and Legal Policy Team
Area 6.21
102 Petty France
London SW1H 9AJ

Tel: 020 3334 6964
Fax: 020 3334 4035
Email: damagesdiscountrate@justice.gsi.gov.uk

Extra copies

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

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 in three months' time. The response paper will be available on-line at http://www.justice.gov.uk/index.htm.

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.

Appendix A.1

Discount rate: statement laid by Lord Irvine of Lairg in the libraries of both Houses of Parliament on 27 July 2001

On 25 June 2001 I made the Damages (Personal Injury) Order 2001 ("the 2001 Order") pursuant to section 1 of the Damages Act 1996. In setting a rate of 2.5% in the 2001 Order I had regard to what I believed to be the accurate figure for the average gross redemption yield on Index-Linked Government Stock for the 3 years leading up to 8 June 2001. Following my announcement of the discount rate, questions were raised as to the correctness of the 3-year average yield figure upon which I had relied.

These questions led me to have the information about the 3-year average yield figure checked thoroughly. Those checks revealed certain limited inaccuracies in the information underlying the average yield figure on which I had based my reasoning in making the 2001 Order. In the light of the correction of that average yield figure, I think it right that I should consider completely afresh, on the basis of the accurate average yield figure, what rate I should have set when I made the 2001 Order on 25 June 2001, in order to determine whether the 2001 Order should be withdrawn.

Decision

Having considered all the material available to me, including the accurate, corrected average yield figure, I have come to the conclusion that a discount rate of 2.5% was the appropriate rate to set. Therefore, I do not consider that the 2001 Order should be withdrawn. This statement sets out my reasons for coming to that conclusion.

Reasons

In determining the discount rate, I have applied the appropriate legal principle laid down authoritatively by the courts, and in particular by the House of Lords in Wells -v- Wells [1999] 1 AC 345.

I also consider that it is highly desirable to exercise my powers under the Act so as to produce a situation in which claimants and defendants may have a reasonably clear idea about the impact of the discount rate upon their cases, so as to facilitate negotiation of settlements and the presentation of cases in court. In order to promote this objective, I have concluded that I should:

a. set a single rate to cover all cases. This accords with the solution adopted by the House of Lords in *Wells -v- Wells*. It will eliminate scope for uncertainty and argument about the applicable rate. Similarly, I consider it is preferable to have a fixed rate, which promotes certainty and which avoids the complexity and extra costs that a formula would entail;

b. set a rate which is easy for all parties and their lawyers to apply in practice and which reflects the fact that the rate is bound to be applied in a range of different circumstances over a period of time. For this reason, I consider it appropriate to set the discount rate to the nearest half per cent., so as to ensure that the figure will be suitable for use in conjunction with the Ogden Tables, which are a ready means for parties to take into account actuarial factors in computing the quantum of damages;

c. set a rate which should obtain for the foreseeable future. I consider it would be very detrimental to the reasonable certainty which is necessary to promote the just and efficient resolution of disputes (by settlement as well as by hearing in court) to make frequent changes to the discount rate. Therefore, whilst I will remain ready to review the discount rate whenever I find there is a significant and established change in the relevant real rates of return to be expected, I do not propose to tinker with the rate frequently to take account of every transient shift in market conditions.

(I consider that the reasoning and conclusions in the above paragraph, which appeared in my original reasons for setting the discount rate in the 2001 Order, continue to apply.)

The principle which I must strive to apply is clear: ". ..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." (*Wells -v- Wells* at 390A-B *per* Lord Hope of Craighead). I acknowledge that claimants who have suffered severe injuries are not in the position of ordinary investors. Such claimants have a pressing need for a dependable source of income to meet the costs of their future care. It is accordingly unrealistic to require severely injured claimants to take even moderate risks when they invest their damages awards.

Setting a single rate to cover all cases, whilst highly desirable for the reasons given above, has the effect that the discount rate has to cover a wide variety of different cases, and claimants with widely differing personal and financial characteristics. Moreover, as has become clear from the consultation exercise (including responses by expert financial analysts to questions which I posed them), the real rate of return on investments of any character (including investments in Index-Linked Government Securities) involves making assumptions for the future about a wide variety of factors affecting the economy as a whole, including for example the likely rate of inflation. In these circumstances, it is inevitable that any approach to setting the discount rate must be fairly broad-brush. Put shortly, there can be no single "right" answer as to what rate should be set. Since it is in the context of larger awards, intended to cover longer periods, that there is the greatest risk of serious discrepancies between the level of compensation and the actual losses incurred if the discount rate set is not appropriate, I have had this type of award particularly in mind when considering the level at which the discount rate should be set. (The above paragraphs also formed a part of my original

reasons for setting the discount rate, and I consider that they continue to apply.)

The House of Lords in *Wells -v- Wells* determined the real rate of return obtainable by claimants through low-risk investment by reference to the gross redemption yields on Index-Linked Government Stock. Their Lordships assumed that a claimant would use his damages award to purchase the right portfolio of Index-Linked Government Stock to ensure that in future years the sums which he received from his portfolio by way of coupon payments and payments on redemption would be sufficient to meet his financial needs. The risk that an early sale of Index-Linked Government Stock might cause capital losses was removed by assuming that such a claimant would hold all his Index-Linked Government Stock until redemption.

The House of Lords thought it appropriate to set the discount rate by reference to the average yields on Index-Linked Government Stock. There is no single correct method by which this average yield may be calculated. Among other factors, the calculation will depend upon the length of the period under consideration, the stocks which are to be included within the average, the inflation assumption made and the form of average taken.

The majority of their Lordships considered it appropriate to set a discount rate by taking a 3-year average of Index-Linked Government Stock yields. I agree that, having regard to the benefits to be obtained in setting the discount rate for the foreseeable future, 3 years is an appropriate period over which to take an average. I note that Lord Lloyd of Berwick preferred a one year period; this confirms the need for judgements to be made in determining the appropriate average yield.

It appears from the speech of Lord Hope at 393E-F that his Lordship had regard to an average of gross redemption yields on Index-Linked Government Stock with lives of over 5 years. He did not give reasons for adopting that particular approach. I am aware that this approach has also been favoured by the Ogden Working Party. However, having regard to the basic reasoning of the House of Lords in *Wells -v- Wells*, I do not consider that I am obliged to follow it. As noted above, the House of Lords in *Wells -v- Wells* assumed that a claimant would generally hold all his Index-Linked Government Stock until redemption. Further, as was stated by Lord Clyde at 395H-396A, it was to be assumed that in each year of loss a proportion of the capital would have to be used. If these two assumptions are to be rendered consistent then it will be necessary for the claimant to purchase Index- Linked Government Stock which will mature in the short term, for otherwise the claimant would have to sell a proportion of his Index-Linked Government Stock prior to redemption in order to realise, in the short term, some of the capital value of his investments. Some claimants, whose losses extend over periods of about 5 years or so or less, would have to purchase all or most of their Index-Linked Government Stock (if that is what they chose to do with the damages paid to them) in this category of stock. I have therefore decided that it is proper to take an average over all Index-Linked Government Stock rather than to exclude Index-Linked Government Stock with less than 5 years to maturity.

Nevertheless, I consider that it would be inappropriate to include the gross redemption yields of such stock which is very near maturity ("near maturity ILGS" -which is stock for which the nominal value of the final coupon and redemption payments have become known with certainty). The gross redemption yield on such near maturity ILGS is a nominal yield rather than a real yield. Accordingly, I asked for a calculation of the size of the real yield element in the gross redemption yields of the near maturity ILGS and have included those real yields within my calculation of the average yield.

The average yield figure upon which Lord Hope relied at 393E-F in *Wells -v- Wells* was based on an inflation assumption of 5%. I consider that, given both the current rate of inflation and the Government's policy aim of maintaining that rate within an upper limit of 2.5%, an assumption of 3% is to be preferred for present purposes.

The House of Lords in *Wells -v- Wells* did not discuss what form of average should be taken of Index-Linked Government Stock yields. One method is to take an average which is weighted in accordance with the market value of each stock. To my mind, such a weighted average is not relevant to the present circumstances, as the choice of Index-Linked Government Stock portfolio which is necessary to ensure that the future financial needs of a claimant are adequately and promptly met does not depend upon the prevailing market values of Index-Linked Government Stock. I have therefore decided that it is appropriate to take a simple average of Index-Linked Government Stock yields.

A calculation of the simple average of the gross redemption yields of an Index-Linked Government Stock (with an appropriate adjustment for the yields of near maturity ILGS) at an assumed rate of inflation of 3% produces an average yield figure of 2.46%. Accordingly, I conclude that the net average yield on Index-Linked Government Stock, as adjusted to take account of tax, lies in the range between 2% and 2.5%. In my opinion, following *Wells -v- Wells*, the discount rate should be set within this range. Further, given that the rate is to be set to the nearest 0.5%, it is clear that the discount rate should either be 2% or 2.5%. I do not consider that the choice whether a rate of 2% or one of 2.5% is appropriate is a simple arithmetical matter, nor that *Wells -v- Wells* requires me to set one rate or the other. I must have regard to the basic principle to which I have referred above, and I have taken account of matters which I consider are relevant to the setting of a discount rate which is just as between claimants as a group and defendants as a group.

In the light of all the information now available to me, and considering the matter completely afresh, I have decided that on 25 June 2001 I should have set the discount rate at 2.5%.

In doing so, I have noted that the real rate of return to be expected from Index-Linked Government Securities tends to be higher the lower the rate of inflation is assumed to be (figures at assumed rates of inflation of 3% and 5% are readily available for comparison). The average gross redemption yield figure of 2.46% assumes an inflation figure of 3% extending into the future. But over recent years inflation has been kept close to or below the 2.5% target set by

the Government, and Government policy and the function of the Bank of England remains firmly to maintain inflation according to that target. Although economists differ as to what inflation rates may be expected for the future, I note that the market's general expectation as to the rate of inflation for the future (as implied by market valuations of gilts) is well below 3%. I consider that it is reasonable to assume an inflation rate for the foreseeable future somewhere below 3%, and this in turn provides comfort that a discount rate set at 2.5% is reasonable. (The above paragraph and the larger part of the following four paragraphs were contained in my original reasons for setting the discount rate. They set out considerations which I consider continue to apply).

I am further supported in my conclusion that a discount rate of 2.5% is reasonable by indications that the rate of return in respect of Index-Linked Government Securities does not represent a pure and undistorted measure of the real rate of return which markets would afford in relation to investments with minimal risk which have emerged from the information which was provided in the responses to the consultation paper and the responses from expert financial analysts which I obtained, and by consideration of rates of return on other investments which are available at low risk to claimants. I have treated the following points as significant.

First, some responses to the consultation maintained that the market in Index-Linked Government Securities is at present distorted so that the prevailing yields are artificially low, and do not necessarily give a reliable indication of the real rate of return which markets would afford in relation to investments with minimal risk. The expert financial analysts whom I consulted concurred that the market is distorted at present. This appears to be a result of the minimum funding requirement introduced by the Pensions Act 1995 (which has, in effect, created additional demand for such securities on the part of pension funds) combined with a reduced supply of government securities generally, as the Government has reduced the national debt. The market in Index-Linked Government Securities has changed significantly since *Wells -v- Wells* was argued and decided. It is widely held that the continuing high demand for Index-Linked Government Stock and the scarcity of supply has led to yields being artificially low as compared with both past record and the yields presently available on similar investment instruments issued by other, comparable, national governments. I consider that the fact that yields in Index-Linked Government Stock appear to be artificially low at present militates against the suggestion that these yields over recent years should be taken as the sole indication of the rates of return that can be achieved through low risk investment in the market. Also, I consider that there is some reasonable prospect of a return to higher rates of return in respect of Index-Linked Government Stock when the Government's already announced plans to abolish the minimum funding requirement are carried into effect. Any distorting effect of the minimum funding requirement would be expected to be particularly pronounced in relation to the longer maturity stocks, whose yields have recently been lower than shorter maturity stocks.

Second, I have noted that the Court of Protection, even in the wake of *Wells -v- Wells*, has continued to invest, on the behalf of claimants, in multi-asset portfolios, including an equity element. Investment in this manner could be

expected to produce real rates of return well in excess of 2.5%. The Court of Protection has specific responsibility to ensure that the financial needs of those for whose benefit it acts will be met, ie its investment objectives are closely similar to those of the prudent claimant which the House of Lords identified in *Wells -v- Wells*. The Court of Protection takes competent financial advice as to the investment strategy which will best secure those objectives. Despite the decision of the House of Lords in *Wells -v- Wells* to set the discount rate by reference to yields on Index-Linked Government Securities, the Court of Protection has continued its former policy, with the agreement of the families concerned, of investing in portfolios comprising of a mixture of equities, gilts and cash. Master Lush of the Court of Protection has stated that none of the families of the Court's patients have chosen to invest in Index-Linked Government Stock since *Wells -v- Wells*, despite having been offered that option. Thus it appears that there are sensible, low risk investment strategies available to claimants which would enable them comfortably to achieve a real rate of return at 2.5% or above, without their being unduly exposed to risk in the equity markets. Although the House of Lords in *Wells -v- Wells* chose not to be guided by the practice of the Court of Protection, this was principally on the grounds that what the Court of Protection might do in the future was uncertain, and not on the grounds that its practice was irrelevant. I consider it is appropriate to take account of what has happened in the period since that decision.

Third, I consider that it is likely that real claimants with a large award of compensation, who sought investment advice and instructed their advisers as to the particular investment objectives which they needed to fulfil (as they could reasonably be expected to do) would not be advised to invest solely or even primarily in Index-Linked Government Securities, but rather in a mixed portfolio, in which any investment risk would be managed so as to be very low. This view is supported by the experience of the Court of Protection as to the independent financial advice they receive. It is also supported by the responses of the expert financial analysts whom I have consulted. No one responding to the consultation identified a single case in which the claimant had invested solely in Index-Linked Government Securities and doubts were expressed as to whether there was any such case. This suggests that setting the discount rate at 2.5% would not place an intolerable burden on claimants to take on excessive, i.e. moderate or above, risk in the equity markets, and would be a rate more likely to accord with real expectations of returns, particularly at the higher end of awards.

Finally, in deciding that a single rate of 2.5% should have been set by me on 25 June 2001, I have borne in mind that it will, of course, remain open for the Courts under section 1(2) of the Damages Act 1996 to adopt a different rate in any particular case if there are exceptional circumstances which justify it in doing so.

Irvine of Lairg
Lord Chancellor

27 July 2001

Appendix A.2

Executive Note
Damages (Personal Injury) (Scotland) Order 2002 (S.S.I. 2002/46)

1. This order has been made in exercise of the power conferred by Section I of the Damages Act 1996 (1996 c. 48), as amended by the Scotland Act 1998 (Consequential Modifications) (No.2) Order 1999 (S.1. 1999/1820, articles 1(2) and 4, Schedule 2, para 126). The instrument is subject to the negative resolution procedure. It was made on 6 February, laid before Parliament on 7 February and enters into force on 8 February.

2. The order was brought into force immediately, and does not comply with the 21 day rule. This is because any delay between the making of the Order and its entry into effect would prejudice settlements of claims for damages for personal injury. This would lead to delays in the courts or in reaching settlements while one or other party sought to postpone cases so as to obtain the benefit of the new rate.

Policy objectives

3. The Order sets the rate of return (the "discount rate") to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury. The courts must take this rate into account unless a party to the action shows that another rate would be more appropriate in the case in question.

4. The objective of an award for damages for personal injury is to put the pursuer in the same position, financially, as he/she would have been if it had not been for the injury. When damages are awarded for personal injury, sometimes a one-off payment will suffice. However, if the injured person will suffer loss of earnings or need care stretching into the future, it may be more appropriate to assess damages in terms of his or her life expectancy and the losses which are expected for the future. The "discount rate" is used to determine how much cash needs to be paid at the time of the award to provide a certain level of income over a period of time. The aim in assessing damages is to provide a capital sum which can be used to yield exactly enough to cover the anticipated needs and lost earnings every year, for so long as they are expected to continue. It is not intended that the pursuer should be left with a capital sum when the period covered by the award has expired.

5. Assessment of the amount of an award is complex. It takes into account the annual cost a pursuer is likely to need, the number of years over which the losses are likely to continue and applies a discount to reflect the effects of paying the whole amount in one lump sum. The discount rate indicates how much a prudent investor should get, allowing for inflation. A high rate means that the injured person need not be paid as big a lump sum in order

to achieve the desired income, and this benefits defenders. Conversely, a low rate benefits pursuers. Rather than argue at length what rate should be set in each case, it aids cases (and promotes settlements) if there is an accepted discount rate, which should be fair to both sides.

6. In the English case of *Wells v Wells* [1998] 3 All ER 481, the House of Lords unanimously concluded that, in order to provide full compensation the discount rate should be taken as 3%, based on the average rate of return from investment in Index Linked Government Securities (ILGS). This was based on the assumption that the successful claimant would invest prudently, and that the prudent investor would put money into ILGS. The judgment made it clear that 3% should be used in other actions, unless there was considerable change in economic circumstances, until a rate was prescribed under Section 1 of the Damages Act 1996. The rate currently used by the courts in Scotland is the 3% laid down in *Wells*.

7. The general approach taken by the Executive is to set a rate which will be not need to be frequently changed, barring any major economic changes. The Lord Chancellor set the rate at 2½% for England and Wales in June 2001, and confirmed his reasoning for this in July 2001. The Executive accepts the reasoning, and believes that there are no particularly Scottish factors that would indicate a need for a different rate. The discount rate represents the rate of return that an award recipient can make on the financial markets. Of course, the same financial markets cover Scotland, England and Wales, so in terms of expected financial returns there is no need for a different rate. A rate of 2.5% was appropriate in June 2001 after allowing for taxation, short term supply factors affecting the ILGS rate, and the ability of pursuers to obtain a higher return in other secure investments. The all stock ILGS rates since then have risen.

Consultation

8. In setting the rate, Section 1 of the Damages Act 1996 provides that there must be consultation with the Government Actuary. His report is attached and recommends a floating rate. The Scottish Ministers believe although there is no technical reason why the rate should be set in steps of ½%, this seems suitable both for ease of calculation and stability of the rate to promote settlements. While the Lord Chancellor must also consult the Treasury, there is no such requirement for Scottish Ministers, but they have sought the Chief Economic Adviser's advice, and his office see no reason in principle why the approach taken by the Lord Chancellor should not be followed.

9. The Executive will shortly consult interested bodies about various matters to do with damages for personal injuries, including questions about what mechanism Scottish Ministers should adopt in future changes to the rate. Consultees will include the Law Society of Scotland, the CHI, the Association of British Insurers and others concerned with all sides of personal injuries litigation.

Financial effects

10. In making their decision, Scottish Ministers were scrupulous in seeking to be fair to both defenders and to pursuers. It would have been wrong for Scottish Ministers to give consideration to their own interests as potential defenders in such cases. In reaching a decision on the rate, they did not consider the financial impact, and limited consideration strictly to what rate will be fair both to pursuers and defenders in personal injuries cases. No regulatory impact assessment was therefore prepared before they made their decision.

11. There will be a financial impact on the public sector both in devolved areas, such as the NHS, and in reserved areas, such as defence. There will also be an impact on insurers, who will bear much of the costs of increased awards against local government, business and private individuals (particularly motorists). The Lord Chancellor's Department has been preparing an assessment for the similar order made for England and Wales in June 2001, and covering all areas, reserved and devolved. When the figures underlying this assessment become available, the Executive will prepare a Regulatory Impact Assessment for the effects in Scotland, and will present this to the Parliament.

Scottish Executive Justice Department

February 2002

Appendix B – Impact Assessment

Title: **Damages Act 1996 s1 – The discount rate: how should it be set?**	**Impact Assessment (IA)**
	IA No: MoJ 107
	Date: 31/07 /2012
Lead department or agency: Ministry of Justice (MoJ)	**Stage:** Consultation
	Source of intervention: Domestic
Other departments or agencies:	**Type of measure:** Secondary Legislation
HM Treasury Government Actuary's Department Justice Directorate, Scottish Government Department of Justice, Northern Ireland Department of Finance and Personnel, Northern Ireland	**Contact for enquiries:** Paul Hughes Tel: 020 3334 3198

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Under section 1 of the Damages Act 1996 a discount rate is applied to lump-sum awards of damages for future costs and losses in personal injury cases. This is because compensation is received in the form of an immediate lump sum payment rather than a stream of future payments; hence the future stream needs to be converted into a single present value (which can then be invested to generate a flow of future payments). The rate is set by the Lord Chancellor for England and Wales, and by the Scottish Ministers and the Department of Justice respectively in Scotland and Northern Ireland. It was last set for England, Wales and Northern Ireland in 2001 and for Scotland in 2002, principally by reference to the three year gross redemption yield of Index Linked Gilts (ILGS). There are concerns that this rate and/or the methodology used to set it may no longer be appropriate. Government intervention would be required to change the rate.

What are the policy objectives and the intended effects?

The Lord Chancellor and his counterparts in Scotland and Northern Ireland are under a duty to set an appropriate discount rate. The policy objective is to select and apply a methodology that will produce a discount rate that is accurate so that so far as possible personal injury claimants are not under-compensated or over-compensated by receiving payment for their future losses and expenses in the form of a lump sum.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The two main policy options that are being considered are:

1. Use ILGS-based methodology applied to current data.
2. Adopt a mixed portfolio methodology applied to current data.

At this stage the Ministry of Justice and its devolved counterparts do not have a preferred option.

Will the policy be reviewed? It will be reviewed **If applicable, set review date:** 2017

What is the basis for this review? PIR. If applicable, set sunset clause date: / N/A

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? Yes

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: .... Date: ....

Summary: Analysis and Evidence Policy Option 1

Description: **ILGS-based methodology applied to current data.**

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate	NQ		NQ	**NQ**

Description and scale of key monetised costs by 'main affected groups'

Costs not quantifiable. A quantitative assessment would require specific data and estimates that are unknown and cannot be estimated with any degree of precision.

Other key non-monetised costs by 'main affected groups'

Financial costs to defendants from a lower discount rate leading to higher lump sum compensation payments if the method results in a lower discount rate compared to now – taking the form of an increased transfer payment from defendants to claimants. Defendants may be insurers, the NHS and other public sector bodies (including national and local governments), and uninsured businesses and individuals. Conversely, if the method results in a higher discount rate, the transfer would be in the opposite direction.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate	NQ		NQ	**NQ**

Description and scale of key monetised benefits by 'main affected groups'

Benefits not quantifiable. A quantitative assessment would require specific data and estimates that are unknown and cannot be estimated with any degree of precision.

Other key non-monetised benefits by 'main affected groups'

Financial benefits to claimants from receiving higher lump sum compensation payments if the method results in a lower discount rate compared to now – taking the form of an increased transfer payment from defendants to claimants. This is assumed to lead to increased business for private health care providers and reduced costs to NHS and local authorities from providing fewer services. Conversely, if the method results in a higher discount rate, the transfer would be in the opposite direction.
Gains to claimants if private health provision provides improved services and treatment compared to NHS and local authority services.[53]
Possible positive behavioural impact on defendants, i.e. incentive to avoid accidents from arising.
Improved levels of equity (fairness) if revised discount rate methodology is considered to produce a more accurate rate.

Key assumptions/sensitivities/risks **Discount rate (%)**

Resource costs of applying the methodology considered not to change and no costs in terms of stability and simplicity of the methodology.
No additional costs for MoJ or for HM Court & Tribunal Service (HMCTS) and their equivalents in Scotland and Northern Ireland (save insofar as they are defendants in personal injury actions).
Distributional implications of increased transfer payments from defendants to claimants, assuming that the discount rate is lower compared to now, are assumed to be valued neutrally by society.
All claimants assumed to be risk averse.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: NQ	**Benefits:** NQ	**Net:** NQ	No	NA

[53] References in this impact assessment to impacts on NHS and local authorities should be read for Northern Ireland as reference to impacts on Health and Social Care and Health and Social Care Trusts.

Summary: Analysis and Evidence Policy Option 2

Description: **Mixed portfolio methodology applied to current data.**

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate	NQ		NQ	NQ

Description and scale of key monetised costs by 'main affected groups'

Costs not quantifiable. A quantitative assessment would require specific data and estimates that are unknown and cannot be estimated with any degree of precision.

Other key non-monetised costs by 'main affected groups'

Financial costs to defendants from lower discount rate leading to higher lump sum compensation payments if the method results in a lower discount rate compared to now – taking the form of an increased transfer payment from defendants to claimants. Defendants may be insurers, the NHS and other public sector bodies (including national and local governments), and uninsured businesses and individuals. Conversely, if the method results in a higher discount rate, the transfer would be in the opposite direction. These financial costs would be lower than under Option 1 assuming the discount rate under Option 2 is higher than that under Option 1.
Reduced stability and simplicity in the methodology compared to the base case and to Option 1.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate	NQ		NQ	NQ

Description and scale of key monetised benefits by 'main affected groups'

Benefits not quantifiable. A quantitative assessment would require specific data and estimates that are unknown and cannot be estimated with any degree of precision.

Other key non-monetised benefits by 'main affected groups'

Financial benefit to claimants from receiving higher lump sum compensation payments if the method results in a lower discount rate compared to now – taking the form of an increased transfer payment from defendants to claimants. This is assumed to lead to increased business for private health care providers and reduced costs to NHS and local authorities from providing fewer services. Gains to claimants if private health provision provides improved services and treatment compared to NHS and local authority services. Conversely, if the method results in a higher discount rate, the transfer would be in the opposite direction.
Possible positive behavioural impact on defendants, i.e. incentive to avoid accidents from arising.
Above benefits would be lower than under Option 1 assuming the discount rate under Option 2 is higher than under Option 1. Improved levels of equity (fairness) if revised discount rate methodology is considered to produce a more accurate rate. In particular Option 2 methodology is assumed to be capable of being more accurate than the base case methodology in reflecting investment preferences of a risk-averse claimant.

Key assumptions/sensitivities/risks **Discount rate (%)**

Resource costs of applying the methodology considered not to change.
No additional costs for MoJ or for HMCTS and their equivalents in Scotland and Northern Ireland (save insofar as they are defendants in personal injury actions).
Distributional implications of increased transfer payments from defendants to claimants are assumed to be valued neutrally by society. All claimants assumed to be risk averse.
Discount rate under Option 2 assumed to be higher than under Option 1.
No firm views held on whether Option 2 is more accurate than Option 1 in reflecting investment preferences of a risk-averse claimant. Possible that Option 2 methodology might be associated with too much risk and hence not accurately reflect the position of a risk-averse claimant.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: NQ	**Benefits:** NQ	**Net:** NQ	No	NA

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	set in Statutory Instrument				
Which organisation(s) will enforce the policy?	n/a				
What is the annual change in enforcement cost (£m)?	0				
Does enforcement comply with Hampton principles?	n/a				
Does implementation go beyond minimum EU requirements?	N/A				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:** n/a		**Non-traded:** n/a		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** 100%		**Benefits:** 100%		

Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[54]	Yes	
Economic impacts		
Competition	No	
Small firms	No	
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		
Health and well-being	Yes	
Human rights	No	
Justice system	No	
Rural proofing	No	
Sustainable development	No	

[54] Public bodies in Great Britain including Whitehall departments are required to consider the impact of their policies and measures on disability, race, sex, gender reassignment, age, marriage and civil partnership, religion and belief, pregnancy and maternity, and sexual orientation under the Equality Act 2010. In Northern Ireland public authorities have a duty under section 75 of the Northern Ireland Act 1998 to consider the impact of their policies and measures on the categories specified in that section.

Evidence Base – Notes References

No.	Legislation or publication
1	Damages Act 1996
2	Published yields on Index Linked Government Stock and other investments
3	Damages The Discount Rate and Alternatives to Lump Sum Payments (March 2000)
4	Page v Sheerness Steel Company; Wells v Wells; Thomas v Brighton Health Authority [1999] 1 AC 345

Evidence Base

1. Introduction

1.1 The Lord Chancellor and his counterparts in Scotland and Northern Ireland have decided that the discount rate set under section 1 of the Damages Act 1996, which is applied to lump sum payments of damages in respect of personal injuries, should be reviewed. Having consulted the statutory consultees,[55] the Lord Chancellor and his counterparts have decided to carry out a public consultation to help establish the most appropriate methodology for setting the rate. The purpose of this Impact Assessment (IA) is to consider the costs and benefits associated with adopting a different methodology.

1.2 This IA does not assess the exact application of the methodology, i.e. does not seek to quantify the precise costs and benefits associated with changing the current discount rate (2.5%) to a specific new rate of X.Y%. If a new discount rate is applied then the IA will be updated accordingly. Nevertheless this version of the IA aims to give an indication of the possible relative size of the discount rate under the two Options. This has been done purely for illustrative reasons.

Basis of consultation

1.3 In setting the rate the Lord Chancellor and his counterparts in Scotland and Northern Ireland are guided by the principles laid down by the House of Lords in the 1998 case of *Wells v Wells*. The Lord Chancellor and his counterparts are not consulting on whether this should be the case.

1.4 The options considered in the consultation paper and this IA are considered to be potentially consistent with those principles. The Government is not obliged to reach any conclusion on what individual claimants might actually do with their awards and, lawfully, **cannot** in setting the discount rate take into account the consequences for defendants of paying awards.

Background

1.5 When person A is injured by person B, person A may have a legal right to civil compensation from person B.[56] This compensation may be agreed between the parties, or ordered by the court, in the form of an award of damages. The principle underlying the calculation of the award is that the claimant should be compensated in full for the loss caused by the injury. The award may take the form of a lump sum or periodical payments or a combination of both. The discount rate is used in cases where a lump sum award covers future losses or expenses, including costs of care and loss of earnings. In cases of serious injury with long term consequences these awards can be very large in total. For example, awards of over £1 million have been made in relation to injuries causing cerebral palsy in a child.

1.6 Instead of making a series of periodical payments for the future losses and expenses the defendant will usually make a single lump sum payment at the outset. In calculating the lump sum to be awarded, account is taken of the fact that it is received in the form of an immediate payment which can be invested, instead of being paid by instalments over time. This conversion of a stream of future payments into a lump sum is made by applying a discount rate. The rate determines the amount by which the nominal total value of all future payments is to be reduced to take into account the future return on investment. For example if a person is due to be paid £10,000 in 10 years' time then paying them £10,000 now would result in over-compensation, as they could invest

[55] The Damages Act 1996, as amended, prescribes that the Lord Chancellor and his counterparts must consult the Government Actuary's Department (GA) and, in addition, the Lord Chancellor must consult HM Treasury (HMT) while the Department of Justice in Northern Ireland must consult the Department of Finance and Personnel.

[56] This excludes compensation paid by the State in criminal cases.

that sum now and benefit from 10 years' worth of investment returns. The purpose of the discount rate is to ensure as far as possible that the injured person receives no more and no less than full compensation.

1.7 The effect of the discount rate on the size of the damages awarded depends on which rate is applied. For example if, in the above example, one assumes a net future return of 5 per cent the £10,000 would be discounted by more than if one assumes a net future return of 3 per cent. In summary a higher discount rate equates to a lower lump sum payment. In practice, parties to litigation can settle out of court, and others will present evidence to the court of the sums that they respectively consider should be paid in damages for future care and loss of earnings using the multipliers specified in the Ogden Tables, which are used to calculate damages and take account of the discount rate.[57] The judge can then decide what figures to accept as the basis for the award of damages.

1.8 There are a large number of personal injury disputes and the discount rate may have to be applied in many of them. There is no central record of how many disputes of this kind occur but the Compensation Recovery Unit (CRU)[58] recorded around 1,040,000 cases in 2011/12. These included clinical negligence, motor, employer, and other types of compensation cases where compensation was claimed against an accident, disease or injury. However, not all of them would have involved using the discount rate or the Ogden tables as they included compensation cases covering both one-off damages awards as well as awards that compensate a claimant for a long-term injury. The total compensation payment in relation to all cases is unknown. However, as an example, the National Health Service Litigation Authority (NHSLA), which is responsible for handling negligence claims made against NHS bodies in England, recorded that in 2010/11 almost £863 million was paid out in relation to clinical negligence claims[59] and over £1 billion was paid out in lump sum damages for clinical negligence between 2008-09 and 2010-11.[60] The NHSLA also recorded that over 21,000 claims were "live" as at 31st March 2011.

1.9 Before the powers conferred by section 1 of the Damages Act 1996 were utilised (in 2001 in England, Wales and Northern Ireland and in 2002 in Scotland) the discount rate was set by the court. Under section 1 the Lord Chancellor and his counterparts in Scotland and Northern Ireland are able to set the discount rate, but the court can adopt a different rate where appropriate in particular cases. The Lord Chancellor and his counterparts are able to review the discount rate so as to ensure that it fulfils its statutory purpose under the Damages Act 1996. The current rate of 2.5% was set by the then Lord Chancellor and the then Scottish Justice Minister, in 2001 and 2002 respectively, broadly by reference to the average gross redemption yield of Index Linked Gilts (ILGS) issued by the UK Government over the preceding three years. The 1996 Act does not specify in detail what criteria should be used when setting the rate nor does it otherwise guide how the rate should be set. Instead it simply provides for a rate to be set for determining the return to be expected from the investment of a lump sum award.

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[57] These are the tables used by parties to litigation to take into account actuarial factors in computing the quantum of damages. The first edition appeared in 1984; the latest (seventh) edition was published on 10 October 2011. The tables are prepared by the Government Actuary's Department with a multi-disciplinary group of actuaries (including the Government Actuary), lawyers, accountants and insurers, chaired by Robin de Wilde, QC. The tables provide an aid for those assessing the lump sum appropriate as compensation for a continuing future pecuniary loss or consequential expense, such as care costs, in personal injury and fatal accident cases. The tables provide factors known as multipliers which are used to assess the present capital values of future annual losses or expenses. The multipliers are based on projected future mortality rates from the 2004-based national population projections for the United Kingdom. As well as providing tables of multipliers, the publication provides explanatory notes as to how the tables should be used. For further information please see http://www.gad.gov.uk/services/Other%20Services/Compensation_for_injury_and_death.html

[58] CRU is part of the Department for Work and Pensions. It works with insurance companies, solicitors and DWP customers, to recover amounts of social security benefits paid as a result of an accident, injury or disease, where a compensation payment has been made. It also works to recover costs incurred by NHS hospitals and Ambulance Trusts for treatment from injuries from road traffic accidents and personal injury claims.

[59] NHSLA financial factsheet 2010/11: http://www.nhsla.com/Publications/

[60] Hansard 8 June 2011 col 358W.

1.10 Setting a single general discount rate avoids the need for a specific rate to be set in each case, thereby simplifying the process of litigation and in particular avoiding the cost of expensive expert evidence arguing the case for both parties. However, investment preferences and rates of return change over time, and this may imply that the discount rate may need to be reviewed from time to time. An inappropriate discount rate produces awards that are either too high or too low, and the effect of a small change in the discount rate can be significant in terms of the size of the lump sum payment. If the discount rate is too low, the size of the lump sum payment may be too large and if the discount rate is too high, the lump sum payment may be too small.

1.11 In the leading 1998 House of Lords case, *Wells v Wells*,[61] Lord Hope of Craighead summed up the purpose of the discount rate as follows: "The measure of the discount is the rate of return which can reasonably be expected on that sum of damages award, if invested in such a way as to enable the plaintiff to meet the whole amount of the loss during the entire period which has been assumed for it by the expenditure of income with capital". He added that: "The assumptions to be made at the stage of selecting the discount rate are simply these. First, it is to be assumed that the lump sum will be invested in such a way as to enable the plaintiff to meet the whole amount of the losses or costs as they arise during the entire period while protecting the award against inflation, which can thus be left out of account. Secondly, it is to be assumed that the investment will produce a return which represents the market's view of the reward to be given for foregoing the use of the money in the meantime. This 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."[62] Applying these principles, the House of Lords decided in the 1998 *Wells v Wells* case that the most accurate way of calculating the present value of the loss that claimants would actually suffer in real terms was to assume an investment of the award of damages in ILGS.[63]

1.12 As mentioned the powers conferred by section 1 of the 1996 Act were utilised (by secondary legislation) in 2001 (England, Wales and Northern Ireland) and in 2002 (Scotland) to prescribe the rate. In setting the rate at those times the Lord Chancellor and the Scottish Justice Minister were guided by the principles laid down by the House of Lords in the 1998 case of *Wells v Wells.*[64] However, the legislation does not specify how the Lord Chancellor and his counterparts in Scotland and Northern Ireland should set the rate so that while the *Wells v Wells* principles provide some guidance, they are not absolutely defining and there is scope to consider options such as those identified in this Impact Assessment. At the same time in relation to all of the proposals in this Impact Assessment claimants are assumed to be a particular category of investors who need to be sure that money will be available to meet their future expenses as they arise. They are assumed to be cautious and risk-averse, and their investments are assumed to be correspondingly low risk. The discount rate is intended to reflect the real rate of return, reflecting such risks, on these investments. The claimant, however, remains free to invest the award as he or she thinks fit. Identifying the appropriate methodology will not in itself have a direct effect on awards of damages, but, depending on its size, a change in the discount rate may significantly increase or decrease the sums payable in awards of damages for personal injuries. However, the consequences for defendants of paying awards are not a matter to be taken into account in setting the methodology underlying the discount rate.

1.13 Whilst the 1996 Act specifically allows the Lord Chancellor and his counterparts to set more than one rate, thus far a single rate has been set covering all claimants. Whilst the consultation document asks if a single rate should continue to be set in future, rather than multiple rates, the analysis in this Impact Assessment assumes that a single rate will continue to apply. This Impact

[61] [1999] AC 345.

[62] Ibid 390G-391C.

[63] Gilts is the name given to bonds issued by the UK Government.

[64] These principles are also relevant for Scotland and for Northern Ireland, even though *Wells v Wells* was an English case.

Assessment will be updated after the consultation period in light of responses and other information received.[65]

Problem under consideration

1.14 The problem under consideration is that the current discount rate of 2.5% and methodology underlying it may be leading to compensation awards that do not fully compensate claimants. This would occur if the discount rate was too high and hence the lump sum was smaller than that stemming from an appropriate discount rate. If the lump sum was invested in low risk investments as intended, such as ILGS, this may have the consequence that the claimants in question may have insufficient resources to pay for the kind of care and other expenses that the compensation settlement had envisaged. This could be financially and personally burdensome for them. It could also result in an additional cost to the State in providing care and health services of the same or a different nature that it would not have had to do if the compensation had been as large as intended. We seek evidence in the consultation paper that accompanies this IA as to how often awards turn out to be inadequate for this reason.

1.15 This situation may arise because the discount rate is intended to measure the real return on the investment of the lump sum award of damages. The rate is set on the basis of assumptions that the lump sum may be invested so as to meet the whole of the claimant's costs and losses as they arise, taking inflation into account, without risk of shortfall at any time.[66] If the discount rate is too high claimants may not receive a lump sum adequate to produce the stream of future income they require for their needs – unless, with success, they take greater risk in their choice of investment to obtain the necessary income than has been assumed in the setting of the rate. In other words claimants might either face a financial shortfall if they select low risk investments or to avoid this they might be forced into selecting higher risk investments, which by definition might also lead to a financial shortfall if the risks materialise.

1.16 To set the rate it is essential to identify an approach to investment that delivers the desired outcomes. Although economic circumstances and investment portfolios may have changed since the rate was set, there is little information as to whether and if so how claimants' investment preferences may have changed throughout this time. As explained, we are considering the hypothetical claimant who is a cautious risk-averse investor; this stems from the principles established by *Wells v Wells*, and we are not consulting on whether those principles should continue to apply. As explained we are assuming that all claimants affected have a uniform attitude towards risk.

1.17 The yield on ILGS has reduced in the last decade while the discount rate and methodology have not been revised. Figure 1 below illustrates what the discount rate would have been had it been updated with data on an ongoing basis, and assuming the current methodology still applies.

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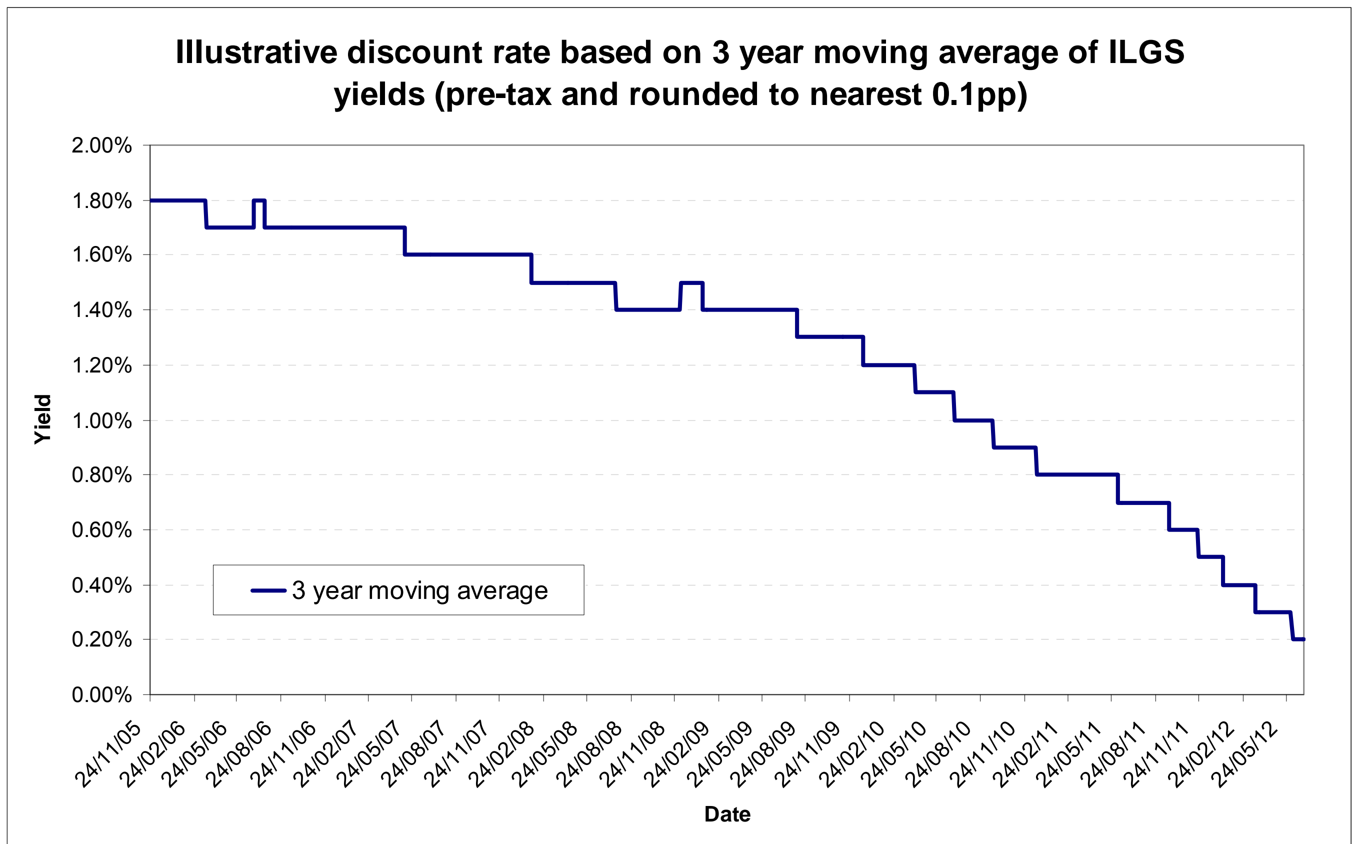
[65] See paras 2.4–2.6 below.

[66] See para 1.8 above.



1.18 In view of these changes since the discount rate was last set, the Lord Chancellor and his counterparts have decided to review the rate and, as part of that review, in light of the advice from the statutory consultees,[67] to review the methodology used to set it. The scale of the issue is difficult to assess. However, as we have mentioned, an indication of the extent of the volume and value of awards may be gauged from the fact that NHSLA paid out over £1 billion in lump sum damages for clinical negligence between 2008-09 and 2010-11[68] and the CRU[69] records around 1,040,000 compensation cases registered in relation to accidents, injury, or disease in 2011-12,[70] although not all would have involved applying the discount rate. In addition to not knowing how many cases involved receiving compensation to cover future expenses and losses, neither the quantum of future payments, their duration in time, nor the time profile of compensation payments is known. In some cases an equivalent sum may not be paid every year, for example if the compensation tapers over time or if a steady stream also involves the addition of lump sums at specific points in time. Therefore, it would not be possible to estimate the impact of a change in the discount rate in terms of what the aggregate change in overall total payments might be. However, as a purely illustrative hypothetical example, assuming that £1 billion of compensation were paid to cover a period of 20 years, with a 19 year investment period, at a discount rate of 3%, this would imply an award of about £770 million. If the discount rate in this purely illustrative hypothetical example changed to 2%, this would imply a compensation payment of around £830 million, representing an additional £60 million. An individual example derived from an actual case was provided by the Association of Personal Injury Lawyers.[71] The claimant was 18 at the time of the accident, which resulted in the claimant requiring a full time residential carer. The claimant was awarded net damages on a lump sum basis of £5,523,093, with an applied discount rate of 2.5%.

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[67] See fn 5, above.

[68] Hansard 8 June 2011 col 358W and para 1.5 above.

[69] http://www.dwp.gov.uk/other-specialists/compensation-recovery-unit/performance-and-statistics/performance-statistics/

[70] See para 1.5 above.

[71] Kingsbury v Burton [2007] EWHC 2091 (QB).

If the discount rate had been 0.5% the claimant would have been awarded £7,537,628.33. The impact is shown in the table below. This is a purely illustrative one-off example and should not be viewed as anything else, for example as being representative of the average case.

Table 1: Case example of net damages at different discount rates

Net Damages on Lump Sum Basis	
@2.5%	£5,523,092.64
@2%	£5,932,703.74
@1.5%	£6,354,329.53
@1%	£6,929,446.53
@0.5%	£7,537,628.33

Economic rationale

1.19 The conventional economic approach to government intervention is based on efficiency or equity arguments. Governments may consider intervening if there are strong enough failures in the way markets operate, e.g. monopolies overcharging debtors, or if there are strong enough failures in existing government interventions, e.g. outdated regulations generating inefficiencies. In all cases the proposed intervention should avoid generating a further set of disproportionate costs and distortions. Governments may also intervene for reasons of equity (fairness) and for redistributional reasons (e.g. reallocating resources from one group in society to another).

1.20 In this case intervention is justified on equity (fairness) grounds. The current discount rate methodology and the way it is applied may result in either over-compensation or under-compensation, and the reforms would be justified if they resulted in increased accuracy in the discount rate.

Policy objectives and proposals

1.21 In setting the rate the Lord Chancellor and his counterparts are acting in a quasi-judicial capacity to fulfil the statutory duty placed on them by the 1996 Act to specify a discount rate. While there is no single ‘right’ rate, the overall aim is to make the rate as far as possible an accurate assessment of the benefit to the claimant of the accelerated receipt of compensation for future losses and expenses.

1.22 Theoretically, the rate might be expected to change as often as the returns on the investments used to calculate it. This would, however, create uncertainty and make it more difficult to settle disputes. Whilst change may become necessary, some degree of stability is desirable from a practical point of view. Similarly, the purest solution might be to leave it to the parties to calculate the rate on a case by case basis. This would be very expensive and also make disputes much harder to settle. A general discount rate is therefore required, which is relatively simple to apply. A single rate currently applies, and this Impact Assessment considers that a single rate will continue to apply in future.

1.23 For these purposes the Lord Chancellor and his counterparts will need to identify suitable investments, to base a methodology on, that risk-averse personal injury claimants might make and ascertain what the return on those investments is likely to be.

1.24 To this end, this IA identifies and examines two broad options as to how the discount rate might appropriately be set:

Option 1: Use ILGS-based methodology applied to current data; or

Option 2: Adopt a mixed portfolio methodology applied to current data.

1.25 A key factor in choosing the most accurate option is the degree of investment risk that the claimant investor is assumed to be willing to take by the person setting the rate (Lord Chancellor and his counterparts), who will be guided by the decision of the House of Lords in *Wells v Wells*.[72] The claimant investor is therefore assumed to be a low risk investor and the discount rate should accurately reflect the rate of return to be expected from the investment that such an investor would make. All claimant investors are also assumed to be homogeneous in this regard. This investment must clearly aim to protect the investor against the effect of inflation. The primary issue therefore is simply what methodology best matches this risk profile. A secondary issue is whether this methodology should be applied to the latest data. The frequency or timing of any further future reviews of either the methodology or of its application in future to the latest data is not the subject of this consultation.

1.26 ILGS provides protection against inflation as measured by the Retail Price Index (RPI). However, even investing in ILGS may carry some risks. For example, to apply a straight average of all ILGS as the basis of the discount rate would be to adopt a simplifying assumption that may not hold in reality because the investor may hold various proportions of different ILGS to match his or her preferred capital and income stream requirements. Additionally, returns on ILGS, which are protected against RPI inflation, may not match the actual inflation which applies to the particular basket of goods and services needed by the claimant investor. ILGS is therefore not completely risk-free. This raises the possibility – and it is no more than a possibility – that assuming a pure ILGS portfolio might not be the only appropriate way in which to set the discount rate. Option 2 is therefore included for consideration.

1.27 Irrespective of the method ultimately chosen, it is only the rate that may change. There is no intention to change either of the following aspects of the current law.

- There is no legal obligation on claimants to invest their funds in accordance with the investment behaviours which underpin the discount rate methodology. Instead, claimants may do what they like with the money received. Nonetheless, we anticipate that where a claimant chooses to invest, the investments chosen may well be affected by the amount of money received relative to his or her requirements and that therefore different discount rates may lead to different investment choices. The *Wells v. Wells* case also indicated that when selecting the discount rate it is to be assumed that the lump sum will be invested in such a way as to enable the claimant to meet their losses or costs throughout the period which applies.
- It is not compulsory for the court to use the prescribed rate. The court may substitute a different discount rate if it is persuaded by one of the parties that another rate is more appropriate. Nonetheless, we understand that in the past the prescribed rate has rarely been challenged.

Affected stakeholder groups, organisations and sectors

1.28 The following individuals/sectors are likely to be affected by the proposal:

a. Claimants in personal injury cases.

b. Legal services providers and financial advisers.

c. Defendants in personal injury cases, including public sector bodies, such as NHS, other businesses and individuals (including those paying insurance premiums), and insurers.

d. Private sector providers of health and care treatments and services.

e. HM Courts and Tribunal Services and the Ministry of Justice and their counterparts in Scotland and Northern Ireland.

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[72] [1999] 1 AC 345.

2. Costs and benefits

2.1 This IA identifies impacts on individuals, groups, bodies and businesses in the UK, with the aim of understanding what the overall impact to society might be from implementing these options. The costs and benefits of Option 1 and 2 are compared to the do nothing base case Option (Option 0). Impact Assessments place a strong emphasis on valuing the costs and benefits in monetary terms (including estimating the value of goods and services that are not traded). However there are important aspects that cannot sensibly be monetised. These might include how the proposal impacts differently on particular groups of society or changes in equity (fairness), either positive or negative.

2.2 This IA looks at different methodologies to derive a discount rate. It provides a qualitative assessment of the costs and benefits of each methodology and provides some detail of the differences between the investment portfolios within each option. The assessment is made with respect to how the various methodologies could deliver the policy objectives where a lump sum award of damages is made for a personal injury.

2.3 As explained above this IA does not consider the precise impacts of moving from 2.5% (the current rate) to a new specific rate in future such as X.Y%. This will be considered in a future updated version of the Impact Assessment once the methodology has been confirmed. However, the IA provides some indication of how the rate might change. These indications should be viewed as purely illustrative.

2.4 In addition as explained earlier a comprehensive evidence base does not exist in relation to the quantum of current compensation payments, and the extent to which these include future payments which would be affected by any change in the discount rate. This makes estimating the impact of a change in the rate difficult. The consultation may not provide adequate information to address the evidence gap alone and we aim to combine it with further analytical work.

Additional evidence gathering

2.5 Additional analytical work over the consultation period will explore the feasibility of reviewing datasets that potentially include settlement information. Possible sources of data include the Association of British Insurers, Association of Personal Injury Lawyers, the Compensation Recovery Unit and Health Service Litigation Authorities. Should appropriate data be accessible, we will attempt secondary analysis to see if this can inform our understanding of the impact of a change in discount rate.

2.6 We will also consider options for more proactive engagement with stakeholders. These approaches may secure views from a wider spectrum of stakeholders than relying upon formal written consultation responses alone, and may also provide deeper evidence than solely relying upon this type of response. Such work may include telephone or face-to-face interviews with individuals from law firms, insurance companies and organisations representing the industry. Others whose views may be obtained include those who have received personal injury settlements (or those who care/support them).

Option 0: Base case (do nothing)

2.7 Option 0 is the methodology used when the discount rate was set in 2001/2 and applied to 2001/2 data. This option is included for comparative purposes only. The key characteristics under Option 0 are:

a. A single rate covers all cases;

b. The rate is set to the nearest half per cent for consistency with the Ogden Tables;

c. The rate was intended to last for a reasonable period; and

d. The rate was set by reference to a simple average of the gross redemption yields on all ILGS over the preceding three years up to June 2001, and adjusted to take account of near maturity stock.[73]

2.8 The final method applied took into consideration several elements, including:

a. Basing the discount rate on all ILGS;

b. Excluding weighting to near maturity stock;

c. Applying a simple average;

d. Not making any express allowance for tax and investment expenses;

e. Rounding the rate.

2.9 The selected method produced an average of 2.46%, which was rounded up to 2.5%. The current yields on ILGS are lower than when the current rate was set and as a result investors, assumed to be risk averse under the *Wells v Wells* principles, may currently either invest in more risky investments than they may have preferred in order to achieve the level of investment returns assumed in the rate, or may take a cut in their investment returns in order to invest in the least risky investments such as ILGS. By definition by investing in riskier investments claimants might also take a cut in their investment returns if the risks materialise.

2.10 This is a do nothing option included for comparative purposes. As its costs and benefits are compared against themselves they are necessarily zero, as is its net present value. If Option 0 were to be adopted the rate would remain unchanged and the 2001/2 methodology would be applied to the 2001/2 data.

Option 1: Use ILGS-based methodology applied to current data

Description

2.11 Under this Option one outcome may be that the method used to set the discount rate would be exactly the same as in 2001/2, as described in Option 0 above. However, this method would be applied using the ILGS data current at the time that the decision to update is made. If this was the outcome, for purely indicative purposes, using the three year gross redemption yield of all ILGS for the three years to July 2012, and making an adjustment for near maturity stock, the derived discount rate might be around 0.2%. However, this would be updated when a final decision is made. The data used to apply this methodology is published on an ongoing basis by the Debt Management Office.

2.12 Under Option 1 it is also possible that some, or all, of the detailed criteria used in the existing methodology might be revised. If this were so then the derived discount rate might differ either side of around 0.2, but is still expected on present market trends to be lower than the current rate of 2.5% which applies in the base case

2.13 The criteria that would be changed would depend upon further consideration following the responses to the consultation and other evidence gathered prior to the consultation response. The criteria that might be reviewed would include:

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[73] Gilts for which the nominal value of the final coupon and redemption payments have become known with certainty.

a. Whether a three year historic average of gross redemption yields should be taken or whether some other period should be used;

b. Whether the average should include all ILGS, or exclude some ILGS, such as excluding ILGS that mature in less than one years time;

c. Whether the average would be weighted or simple, and therefore whether the assumption that the hypothetical claimant holds all stock until redemption is appropriate;

d. Whether any allowance should be used for tax and investment expenses and how rounding should be applied.

2.14 Precise costs and benefits would depend on the specific choices made as to how the various criteria would be applied. These are not set out here as there are numerous combinations that could produce various different discount rates. However, for purely illustrative purposes only, we identify three variations of these criteria to enable a comparison of how these might affect the discount rate, as presented below. We invite views on all these issues in the consultation paper that accompanies this IA.

2.15 It is considered that revisions to the criteria might enable the risk attitude of claimants to be matched more accurately than in the base case. No firm views are held at this stage about how the proposals in Option 1 and those in Option 2 differ in this regard.

Possible Criteria Changes

a. Whether a three year historic average of gross redemption yields should be taken or whether some other period should be used.

2.16 One criterion to change might be the period over which the average of the gross redemption yield is calculated. For example, rates could be produced by taking 1, 3, and 5 year historic averages of all ILGS (removing stocks maturing within less than 7 months of the business day). Whether say a 5 year rate is lower or higher than a 3 year rate would depend upon whether rates are declining over time or whether they are increasing over time.

2.17 In relation to historic averages in principle the present rates of return are the best rates to predict future returns. The further back the average goes, the higher the risks associated with a discount rate that captures a return on investment that was expected in the past, rather than the present, on the basis of how the economy performed throughout past years. However, taking historical averages could smooth out any volatility in the economy during a shorter period of time that may be reflected in yield rates. Different approaches would have different effects on claimants. Furthermore, there could be numerous alternative options that are open for consultation responses, such as taking projected ILGS rates.

b. Whether the average should include all ILGS, or exclude some ILGS, such as excluding ILGS that mature in less than one year's time.

2.18 Another criterion to consider could be to exclude some ILGS stocks from the ILGS average, for example to exclude all those stocks that expire in less than one year. This would assume that claimants tend to invest their money in longer-term stocks.

2.19 Assuming all other criteria remain the same, excluding short-term stocks (e.g. stocks that expire in less than one year) would assume that investors would not hold any investments that expire within that time. If other stocks were excluded, a similar assumption would apply. For example, stocks expiring within the next three years could be excluded on the assumptions that investors use returns on their investments throughout those three years, and no capital.

c. Whether the average would be weighted or simple, and therefore whether the assumption that the hypothetical claimant holds all stock until redemption is appropriate.

2.20 Another possible criterion to consider would be to apply a weighted average rather than a simple average to all ILGS. Using a simple average does not take account of the fact that the bonds will mature at different times and so be held by the investor for different periods. In reality investors may redeem proportions of their investment on a regular basis, for example yearly, which may not reflect the ILGS maturity dates. Furthermore, investors may redeem their capital investments in different proportions throughout the lifetime of their investments, rather than equal proportions as assumed by a simple average. Weighting by duration mathematically takes account of the effect of different bonds' maturities on the overall yield from the portfolio.

d. Whether any allowance should be used for tax and investment expenses and how rounding should be applied.

2.21 Further adjustments may be made, including applying a different rounding basis, changing the manner in which allowance is made for inflation, tax and investment expenses and creating a different rate for different cases. These will give rise to a number of different issues. Decisions as to the extent to which rounding is permitted will affect the possible range of rates – and it is clear that there is no single right rate – within which the rate may fall. Whether this would produce a more accurate rate would depend on the factors taken into consideration, although it should do so. The effect of making allowance for inflation, tax and investment expenses will also depend on the assumptions made. Ideally, they would lead to a more accurate rate. Setting differing rates for specific categories of cases may raise complications in litigation cases which could ultimately increase legal costs and the time required to determine cases, detracting from simplicity of application of the rate if not its calculation.

Conclusion

2.22 As explained above, changing the criteria might lead to the discount rate being either higher or lower than it is currently. The extent of this would depend upon the nature and combination of the criteria changes, but using current data the discount rate is still expected to be below the current rate of 2.5%.

Option 1: Costs

Costs to Claimants

2.23 In relation to the methodology per se, the costs to claimants of changing the methodology would depend on the specific changes adopted. There might be costs to some particular individual claimants if, compared to the current methodology, the new methodology reflected their risk preferences less accurately. For example some claimants may prefer different weighting or different length averages depending upon their personal circumstances and upon the length of time over which their compensation applies. The consultation exercise should shed light on whether, overall, this methodology reflects the preferences of a cautious risk-averse claimant more closely than does the existing methodology. This may indicate whether this methodology is likely to produce a more accurate rate than the base case methodology.

2.24 If the ILGS criteria were revised then claimants and/or their investment advisors would incur familiarisation costs associated with changes to the methodology, and may incur ongoing resource costs from application of the new methodology. These may include costs of finding investment portfolios which match the discount rate. It is unclear whether there would be increased resource costs from managing the investment portfolio as a result of the discount rate methodology changing. Even if such costs arose an allowance may be made in some compensation awards for defendants to pay claimants' investment costs.

2.25 If the ILGS criteria were revised the discount rate is not expected to differ compared to the base case methodology so far as the stability of the discount rate set is concerned, the discount rate is not expected to be more difficult to apply than a discount rate set under the base case methodology, and the resource costs of coming to a settlement are assumed to be the same as in the base case, in the absence of evidence to the contrary.

2.26 If the methodology was kept exactly the same as under the base case there would be no expected additional resource costs to claimants directly from applying this methodology per se, and the rate produced would be as accurate, stable and simple as previously, so no new costs would arise in these respects.

2.27 The resource costs of coming to a settlement are considered to be the same, including legal costs. In theory it is possible that a change in the discount rate may have implications for the time and resource taken to resolve a case. In practice there is no available evidence on this hence the costs of coming to a settlement are assumed to be the same.

2.28 The resource costs of managing the lump sum have been assumed to be broadly the same in proportion to the size of the lump sum, although the lump sum would be larger if the discount rate was lower. These costs may include investment costs paid to financial advisers for creating and running a portfolio. In some cases an allowance may be made in compensation awards for defendants to pay claimants' investment management costs.

Costs to Defendants, including insurers and the NHS and its counterparts in Scotland and Northern Ireland

2.29 If the ILGS criteria were revised there may be one-off costs to defendants from familiarisation with the new discount rate methodology. As in relation to claimants, there may be no difference to defendants in relation to the stability of the rate once set and the simplicity of applying it.

2.30 If the methodology is kept the same as for the base case then, compared to it there would be no expected additional resource costs to defendants from applying the discount rate methodology per se and, as in relation to claimants, no other costs in terms of accuracy, stability and simplicity.

2.31 However, even if the methodology is the same, there may be costs to defendants associated with the application of the same methodology to a more recent dataset. If as a result the discount rate goes down, the size of lump sum payments will go up, to the cost of defendants. In effect this would take the form of a transfer payment from defendants to claimants.

2.32 In so far as an allowance is made in compensation payments for defendants to cover claimants' investment management costs (as paid to advisers to manage their funds) this might be passed to defendants but would presumably be unchanged if the assumed portfolio of ILGS remained the same.

2.33 As for claimants, it has been assumed that the costs of coming to a settlement are the same as in the base case, in the absence of evidence to the contrary.

2.34 Defendants may be insurers, and an increase in outlays for insurers may lead to higher insurance premiums to cover this. Those insured might include businesses, government bodies and individuals. Not all defendants might be insured. In particular the NHS and its counterparts are likely to incur costs directly as a result of an increase in the size of lump sum payments. This might have implications for health service provision.

Costs to MoJ (including HM Courts and Tribunal Service (HMCTS)) and their counterparts in Scotland and Northern Ireland

2.35 There would be no significant additional resource costs to MoJ (including HMCTS) and its counterparts in Scotland and Northern Ireland from updating the rate by applying new data to the existing methodology. The data used for this purpose is published on an ongoing basis.

Distributional Costs

2.36 If the discount rate was lower than under the base case and lump sum payments were higher then there would be a transfer of resources between individuals, businesses and public bodies, in the ways outlined above and also in the benefits section below. No views are held about whether these distributional implications per se are viewed positively or negatively overall by society.

Option 1: Benefits

Benefits for Claimants

2.37 At this stage it has been assumed that the methodology is capable of being more accurate than that under the base case if the ILGS criteria are revised. Claimants are considered to place an intrinsic positive value on the methodology being more accurate per se – this being separate from the value they place on the implications of a more accurate discount rate (i.e. from receiving a higher/lower lump sum). For example:

- Changing the discount rate to be based on the average ILGS over the past one year would reduce the risk associated with outdated expectations on returns on investment, as compared to an average over the past three or five years. On the other hand, assuming the discount rate would not change for some time, future claimants may be worse off if economic expectations change significantly while the discount rate were based on a single year during which the economic climate differed.
- Assuming all other criteria remain the same, excluding short-term stocks (e.g. stocks that expire in less than one year) would assume that investors would not invest in such stocks. This would reduce risks associated with a discount rate that places weight on short-term investments, and produce a more accurate result for claimants who invest in longer-term investments. It is assumed that excluding short-term stocks would represent the hypothetical claimant more appropriately, and be beneficial to most claimants who invest over a longer-period of time. We are seeking evidence on the duration of awards in the consultation paper accompanying this impact assessment.
- A weighted average of ILGS by duration would estimate the actual yield from holding a portfolio of ILGS more accurately, and would provide a better match of the yield with the actual investment returns over that period.

2.38 Assuming a more accurate rate is derived, claimants would benefit from an overall reduced level of risk management required. For example, claimants may currently use investment managers to manage risk associated with simplifying assumptions. If the methodology produces a lower rate than the base case then claimants will benefit from the increased size of the lump sums, but conversely suffer a reduction from the decreased size if the rate is higher.

2.39 In addition should the methodology remain unchanged there would still be benefits associated with applying the current methodology to more recent data. In particular if the discount rate goes down, the size of lump sum payments will increase, to the benefit of claimants. This would take the form of a transfer payment from defendants to claimants. Assuming claimants are risk averse, they would no longer be under-compensated due to applying the methodology to outdated data that does not match existing ILGS yield rates, or alternatively, claimants would no longer invest in assets that have higher risk-return characteristics than they would prefer.

2.40 This increase in payments to claimants is assumed to be used (in part) by claimants to purchase improved treatment and care services compared to what the claimants would otherwise have received from the NHS and from local authorities.

2.41 As explained above there would be no benefits relating to the costs of coming to a settlement or the costs of managing the investment portfolio.

Benefits for Defendants, including insurers and the NHS and its counterparts in Scotland and Northern Ireland

2.42 At this stage it has been assumed that the ILGS methodology is capable of being revised to make it more accurate than that under the base case. Defendants are considered to place an intrinsic positive value on the methodology being more accurate per se – this being separate from the value

they place on the implications of a more accurate discount rate (i.e. from paying a higher/lower lump sum).

2.43 If the methodology produces a lower rate there are no expected additional benefits to defendants directly from applying current data to the methodology. As explained above there would be no benefits relating to the costs of coming to a settlement.

2.44 If the discount rate was lower and if lump sum payments were higher then it is possible in theory that this might generate increased levels of business for insurers. There is no available evidence to support this.

2.45 If lump sum payments were higher then, as explained above, claimants might to some extent switch from using NHS and other publicly provided treatments and services to using privately funded services. If so, the NHS and local authorities may benefit from a reduced call upon their services from claimants receiving lump sums. This may have positive resource implications for NHS and local authority service providers.

Benefits for Private Health Providers

2.46 If the discount rate was lower and lump sum payments were higher then, as explained above, there might be an increased demand for privately funded health care provision. This might include a substitution from state funded services to privately purchased services, and also an overall increase in the level and type of treatments and services consumed by the claimant. Conversely, if the rate were higher.

Benefits to society and wider economy

2.47 As for claimants and defendants, the rest of society in general is assumed to place an intrinsic positive value on the methodology itself being more accurate and, at this stage, it has been assumed that revisions to the ILGS criteria are capable of leading to the ILGS methodology being more accurate than that under the base case.

2.48 Even if the methodology remains unchanged society may also benefit from applying more recent data if this was considered to generate an increase in equity (fairness) as a result of there being less under-compensation from the discount rate not matching claimant risk profiles accurately enough.

2.49 It is possible that an increase in lump sum payments may have a positive behavioural impact on defendants who cover these costs. This may include the deterrent effect of preventing accidents from arising.

2.50 It is possible that an increase in lump sum payments may generate wider economic benefits as a result of the implied change in investment activity and investment patterns. There is no available evidence to support this on a macroeconomic level.

Distributional Benefits

2.51 As explained above, if the discount rate was lower and lump sum payments were higher then there would be a transfer of resources between individuals, businesses and public bodies, in the ways outlined above. No views are held about whether these distributional implications per se are viewed positively or negatively overall by society.

Option 1: Other Risks and Assumptions

2.52 Claimants are assumed to be risk averse investors and ILGS is assumed to be a very low risk investment.

2.53 There may still be some risks associated with the methodology through the simplifying assumptions it makes. For example, it may be difficult in practice for investors to find investments that match the derived discount rate even if they invest in ILGS, because, for example, they may invest for a different length of time than we have implicitly assumed in our calculation. These risks exist with the current methodology and could still exist if the criteria applying to the methodology are changed and could generate a cost as much as a benefit.

2.54 It has been assumed that society overall places a neutral value on the distributional implications, i.e. on claimants gaining at the expense of defendants or vice versa.

Option 2: Adopt a mixed portfolio methodology

Description

2.55 A second Option is to move away from an ILGS-only based approach to a mixed portfolio of investments approach. A mixed portfolio could take a number of forms. For illustration, three possible portfolio types have been identified, although views on other alternative portfolios are welcome in response to the consultation.

2.56 The proposals under Option 2 are considered to be capable of matching the risk attitude of claimants more accurately than in the base case. No firm views are held at this stage about how the proposals in Option 1 and those in Option 2 differ in this regard.

2.57 The three possible portfolio types, which are drawn from the Association of British Insurers (ABI) classification,[74] are:

a. **Mixed Investment 0%-35% Shares**
- Funds should hold a range of different investments.
- Maximum of 35% total shares (including Preference Shares, Permanent Interest Bearing Shares and Convertibles).
- No minimum share requirement but managers' stated intention retains the right to invest in shares.
- Minimum of 85% Sterling based investments (including fixed interest hedged back to Sterling).
- Fixed interest defined as Government Sovereign Bonds and Corporate Bonds.

A portfolio of this kind might be associated with moderate risk to capital value and slight risk of insufficient investment growth.

b. **Sterling Fixed Interest**
- Funds which invest at least 80% of their assets in Sterling-denominated (or hedged back to Sterling) broad investment grade fixed interest securities.
- Fixed Interest securities defined as Government sovereign bonds, local authority bonds, supranational bonds and corporate bonds. Preference shares, permanent interest bearing shares (PIBs) and convertibles are not treated as broad investment grade fixed interest investments.

A portfolio of this kind might be associated with slight risk to capital value and moderate risk of insufficient investment growth

c. **Money Market**
- Funds which invest at least 95% of their assets in sterling (or hedged back to sterling) money market instruments.
- Money market instruments are defined as cash and near cash, such as bank deposits, certificates of deposit, and fixed interest securities or floating rate notes.

A portfolio of this kind might be associated with negligible risk to capital value and slight risk of insufficient investment growth

2.58 This approach would be more complicated that one relying on investment in ILGS alone. Nonetheless, information about financial products is widely available and obtaining data should not be particularly problematic. The additional complication would also be reflected in the input required to create and manage investment portfolios on behalf of actual claimants so as to match the discount rate.

2.59 The actual costs and benefits of adopting this option would depend on the specific content of the portfolio, but typically it is expected that, on average, over the long term these alternative portfolios give higher returns than a yield based on ILGS.

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[74] http://www.abi.org.uk/Life_Funds/Sector_Parameters.aspx

2.60 In conclusion for the purposes of this Impact Assessment it has been assumed that the discount rate under Option 2 might be lower than under the base case (2.5%) but higher than under Option 1.

Option 2: Costs

2.61 Assuming that the discount rate is lower than under the base case then lump sum payments would be higher. All of the impacts under Option 1 associated with higher lump sum payments would also apply to Option 2, but to a lesser degree as the discount rate under Option 2 is considered to be higher than that under Option 1.

2.62 The remaining differences between Option 2 and the base case relate to the application of the different methodology per se. These impacts are set out below.

Costs to Claimants

2.63 The individual risks (including volatility) of investing in line with Option 2 will be different and at different levels to Option 1. There may be increased costs associated with some of these differences, for example there may be additional volatility arising from holding shares in firms or other investments where risk of default exists. However, it may be that the overall level of risks between the ILGS-based methodologies and this option are similar and represent similar costs. This is being considered as part of the consultation.

2.64 More specific detail around the risks associated with the investment portfolios is discussed below:

- **Mixed Investment 0-35% Shares:** These hold up to 35% of the money invested in shares, and assume that the remaining investment would be held in bonds. The capital investment would be more volatile than ILGS-only investments due to shares held, although this might be 0%. There would also be a higher level of credit risk on the capital value associated with companies defaulting and, if some proportion of the investment is held in non-Sterling investments, there could be a risk arising from exchange rate fluctuations, although this is expected to be minimal as no more than 15% foreign currencies can be held. Although equities offer some protection against inflation, they are not index-linked, unlike ILGS. Therefore capital values could fluctuate, leading to a risk that an investor forced to sell to meet costs as they arise will get a low price for the asset and deplete the award of damages more quickly than planned. Due to the higher volatility of the investment there is a higher expected investment growth. This would result in an overall slight risk on the investment growth.
- **Sterling Fixed Interest:** These funds can invest in a mix of long and short-term investments, and a mix of Government and corporate bonds. This option would be riskier and therefore possibly more costly for claimants than the current methodology as there would be a slightly higher risk with respect to the value of capital investment. This is because of the risk of default associated with corporate bonds, and unlike Government bonds, the capital and return are not guaranteed. However, such funds typically invest in a diversified portfolio of "investment grade" corporate bonds with higher credit ratings, so the risk to capital is only slight. There would be a risk that inflation would deplete the purchasing power of the real return on the investments as they are not index-linked, unlike ILGS. This is particularly so for long-term bonds. Overall there is a moderate risk that the investment growth would be insufficient (in real terms).
- **Money market:** These funds typically invest in short term, low-risk instruments to reduce overall investment risks. There is little additional risk to the capital value invested due to the kind of investment and therefore this risk is expected to be negligible. There would be some additional risk in investment growth due to the short-term nature and the speed of the investment turnover. There would be some additional risk that the discount rate would be weighted towards the expected rate of return on short-term investments. This would create a cost in future if such rates of return are no longer available when claimants reinvest their money. These investments may be less stable than the existing methodology as risks and returns may fluctuate over the long-run.

2.65 Creating the methodology under Option 2 will be more complex than creating a methodology under Option 1. If Option 2 is chosen claimants might require expert financial advice more often to achieve the rates of return consistent with the discount rate.

2.66 There may be investment advice and investment management costs associated with the variability of future rates of return on non-ILGS investments as they are unlikely to remain as stable as ILGS based portfolios.

2.67 Under Option 2 there may be increased resource costs from managing the investment portfolio as a result of the discount rate methodology changing. However, this is not certain as claimants will still have to assemble a portfolio if option 1 is chosen. As explained above, even if such costs arose an allowance can be made in compensation awards for defendants to pay claimants investment management costs.

2.68 The resource costs of coming to a settlement are assumed to be the same as in the base case, in the absence of evidence to the contrary.

Costs to Defendants, including insurers and the NHS and its counterparts in Scotland and Northern Ireland

2.69 There may be one-off costs to defendants from familiarisation with the new discount rate methodology. If the methodology under Option 2 is more complicated than the base case methodology or the rate set under it requires changing more frequently than under the base case then this might be worse for defendants (in the same way that it might also be worse for claimants).

2.70 As explained above, if increased resource costs (e.g. from financial management) are associated with applying the Option 2 methodology then these might be passed to defendants.

2.71 The resource costs of coming to a settlement are assumed to be the same as in the base case, in the absence of evidence to the contrary.

Costs to MoJ (including HM Courts and Tribunal Service (HMCTS)) and their counterparts in Scotland and Northern Ireland

2.72 There may be costs to MoJ and its counterparts in Scotland and Northern Ireland associated with reviewing the discount rate as this would imply deciding that a specific set of investments would have to be identified and selected in order to apply the methodology. These costs could be increased if the portfolio is diverse and data is not readily available in relation to all of the investments included. Significant additional costs are not anticipated for HMCTS and its counterparts in Scotland and Northern Ireland.

Distributional Costs

2.73 If the discount rate was lower than under the base case and lump sum payments were higher then there would be a transfer of resources between individuals, businesses and public bodies, in the ways outlined above and also in the benefits section below. Conversely, if the rate were to be higher. No views are held about whether these distributional implications *per se* are viewed positively or negatively overall by society.

Option 2: Benefits

Benefits to Claimants

2.74 In relation to the accuracy of the rate it is unclear whether the Option 2 methodology is better or is worse than the base case methodology. The consultation exercise should shed more light on this. At this stage it has been assumed that the methodology under Option 2 is capable of being more accurate than that under the base case. Claimants are considered to place an intrinsic positive value on the methodology being more accurate per se – this being separate from the value they place on the implications of a more accurate discount rate (i.e. from receiving a higher/lower lump sum). If the methodology produces a lower rate than the base case then claimants will benefit from the increased size of the lump sums, but conversely suffer a reduction from the decreased size if the rate is higher.

Benefits to Defendants, including insurers and the NHS and its counterparts in Scotland and Northern Ireland

2.75 As explained above, in relation to the accuracy of the rate it is unclear whether the Option 2 methodology is better or is worse than the base case methodology. The consultation exercise should shed more light on this. At this stage it has been assumed that the methodology under Option 2 is capable of being more accurate than that under the base case. Defendants are considered to place an intrinsic positive value on the methodology being more accurate per se – this being separate from the value they place on the implications of a more accurate discount rate (i.e. from paying a higher/lower lump sum). If the methodology produces a higher rate than the base case then defendants will benefit from the decreased size of the lump sums, but conversely suffer an extra cost from the increased size if the rate is lower

Benefits for Private Health Providers

2.76 If the discount rate was lower and lump sum payments were higher then, as explained above, there might be an increased demand for privately funded health care provision. This might include a substitution from state funded services to privately purchased services, and also an overall increase in the level and type of treatments and services consumed by the claimant. Conversely, if the rate were higher.

Benefits to society and wider economy

2.77 As for claimants and defendants, the rest of society in general is assumed to place an intrinsic positive value on the methodology itself being more accurate, and at this stage it has been assumed that the methodology under Option 2 is capable of being more accurate than that under the base case.

Distributional Benefits

2.78 As explained above, if the discount rate was lower and lump sum payments were higher then there would be a transfer of resources between individuals, businesses and public bodies, in the ways outlined above. Conversely, if the rate were to be higher. No views are held about whether these distributional implications per se are viewed positively or negatively overall by society.

Option 2: Other Risks and Assumptions

2.79 It is assumed that a mixed portfolio can produce an accurate discount rate outcome. It is assumed that claimants use financial advisers currently, and that there would be no additional financial expertise required for claimants.

2.80 It is assumed that it is possible to construct a portfolio of investments under Option 2 that are broadly equivalent in risk and return terms to ILGS portfolios. It is also assumed that some claimants' preferences may be less risk-averse than assumed by ILGS portfolios and some claimants invest in portfolios with similar risk-return profiles to match a discount rate based on market investment portfolios. There is a risk that some claimants are very risk-averse investors, in which there would be higher costs to claimants around the risks outlined above.

2.81 It has been assumed that society overall places a neutral value on the distributional implications, i.e. on claimants gaining at the expense of defendants or vice versa.

Overall Comparison of methodologies

2.82 We have indicated that we would expect that the discount rate might be lowest under Option 1, followed by Option 2 followed by the base case (Option 0). A lower discount rate would equate to a higher lump sum payment for the claimant.

2.83 All the options should provide a rate that produces an appropriate adjustment for protection against inflation in the calculation of the award of damages. The challenge is to choose the option that produces the most accurate expected rate of return. This will depend on the detail of the options but a general comparison may be helpful.

2.84 The proposals under Option 1 and Option 2 are considered to be capable of matching the risk attitude of claimants more accurately than in the base case. No firm views are held at this stage about how the proposals in Option 1 and those in Option 2 differ in this regard.

2.85 All the Options will produce a rate, which may be found in the Ogden Tables. The application of the new rate should therefore not be unduly complicated under any Option. In terms of relativities the Option 2 methodology is considered to be more complicated, for example it will have more types of assets in the portfolio.

2.86 None of the Options are expected to produce rates that need to be reviewed frequently. However, reviews may be more frequent under the Option 2 methodology. Differences in stability may be more relevant to choices of options within the Options than as between the Options.

One In One Out (OIOO) Assessment, micro-business moratorium and sunsetting

2.87 The choice of the methodology for setting the discount rate and the subsequent actual setting of the rate do not appear to fall within the definition of regulation.[75] Nevertheless, as, like his counterparts, the Lord Chancellor is proposing to consider changing the discount rate, any new discount rate can subsequently be taken into account by the court when determining settlements, and the defendants in those cases are likely to include businesses. As such, business costs may be generated by the possible changes identified in this IA. If OIOO were to be applied to the

[75] "A rule or guidance with which failure to comply would result in the regulated entity or person coming into conflict with the law or being ineligible for continued funding, grants or other applied for schemes. This can be summarised as all measures with central force imposed by central government and other schemes operated by central government." One-In, One-Out (OIOO) Methodology July 2011 para 13.

proposals under consideration in this IA, the resulting impacts on businesses would be as explained below.

2.88 Under the Options presented in this IA (apart from the base case) the discount rate is expected to fall and hence lump sum payments to claimants from defendants are expected to rise. Claimants are invariably individuals, not businesses. Where these payments from defendants are made directly by businesses, such as insurers, a cost to business would be generated. These costs might be considered as an IN for business. Not all defendants are insurers, for example the NHSLA is a public sector body.

2.89 These payments could be used by claimants to purchase treatments and health care from private providers, which are businesses, instead of receiving them from public sector providers such as the NHS and local authorities. This would generate an OUT for business.

2.90 The proposals in this IA are not expected to yield any significant costs or benefits for legal services providers. The resource costs of applying a different discount rate methodology are not expected to be significant.

2.91 Given the increased size of lump sum payments and associated larger investment portfolios there might, at the margin, possibly be increased levels of business for insurers and for financial services providers. Any such effects are not expected to be significant at a macroeconomic level.

2.92 In conclusion, if OIOO were to apply, the proposals in this IA are expected to generate a zero in for business.

3. Enforcement and Implementation

3.1 The assumption for the proposal is that the appropriate methodology will be used by the Lord Chancellor and by his counterparts in Scotland and Northern Ireland when they come to decide, independently, what the discount rate ought to be. They will also decide independently when the new rate should apply.

3.2 The discount rate is specified so that it may be applied by the courts in the award of damages. The courts can apply a different rate if occasion requires. The application of the rate is not enforced, although it is to be expected that the parties to a dispute will be attentive to the application of the rate as it will affect the sum of money to be paid or received.

4. Specific Impact Tests

Equality Impact Assessment

4.1 An initial Equality Impact Assessment screening for England, Wales and Scotland is attached at Annex 2. An equality screening completed by the Department of Justice, Northern Ireland in relation to its statutory duties under section 75 of the Northern Ireland Act 1998 is attached at Annex 3. We have identified a range of equality stakeholders and have sought their views on the issues generated in the consultation paper accompanying this impact assessment.

Competition Assessment

4.2 We have carried out a competition assessment and do not anticipate that the choice of the method of setting the discount rate will have any competition impact. Any effect will be indirect and will depend on the nature of the change to the discount rate (if any). The choice of methodology and the rate will apply to all businesses irrespective of their size as any business found liable for a personal injury must pay full compensation to the claimant.

Small Firms Impact Test

4.3 We have considered the impact of how the discount rate will be set on small firms. As the methodology does not regulate any activity of small firms any effect of the choice of methodology on them will be indirect.

4.4 We do not consider that the choice of methodology will affect the operations or performance of small firms or affect them differently from other businesses. This is because the discount rate is applied by the court to its quantification of an established legal liability in personal injury cases. The application of the rate allows the court to take account of the accelerated payment inherent in the lump sum payments of damages, thereby preventing under- or over-compensation. This precludes any alternative approach or exemptions being applied in cases involving small firms.

4.5 Making enquiries of small firms as to the possible effect of a choice of methodology before the consultation paper had been published would be premature. We will however seek views about any effect there may be on small firms in the consultation paper and will carry out a small firms survey as part of the consultation process to ensure that the effect of the choice of methodology on small firms is properly understood and any possible alternative approaches for small firms properly considered.

Environmental Impacts

4.6 We do not anticipate any major environmental impacts from the choice of the method of setting the discount rate. This exercise has no physical consequences. The setting of the rate will only affect the level of lump sum damages payments in personal injuries cases. It will not generate any environmental consequences.

Health Impact Assessment

4.7 We do not anticipate any significant impact on human health or the demand for health and social care services in the UK as a consequence of the choice of the method of setting the discount rate. The choice of methodology and the choice of rate are intended to support the fulfilment of the objective of full compensation achieved by return on investment made at an appropriate degree of risk. If the method chosen to set the rate cannot produce an appropriate rate or the rate is inappropriately set notwithstanding the method chosen is appropriate there may be under-compensation. This could have health and social care consequences for the individual as he or she may not be able to afford appropriate care. The inability to buy care may mean that the person is reliant on public provision. As we expect both the method and the rate to be appropriate, we consider the chance of this occurring to be small. The result of our initial health screening test is that a full health impact assessment is unnecessary.

Human Rights

4.8 The consideration of a range of possible methods for the setting of the discount rate has been subjected to a Human Rights screening to ensure that they are compliant with the Human Rights Act 1988.

Justice Impact Test

4.9 Justice impacts have been considered and as the choice of methodology for the setting of the discount rate is not expected to increase the volume of cases that will go through the court system, it is not expected that the proposal will have a significant justice impact. Nor will the change of the rate occasion the court or the parties any additional work where the new rate is applied. In those cases where the rate is challenged as inappropriate for the case in question – which we understand are very few – the party making the challenge will need to convince the court another rate is appropriate. This is the situation at present and the amount of work required to challenge a new rate (and underlying methodology) is unlikely to be much different from the work required to challenge the present rate.

Rural Proofing

4.10 We have carried out a rural proofing assessment and do not anticipate that any rural impacts will be different from the rural impacts (if any) of the present rate and methodology. This is because the actuarial tables used to calculate damages do not distinguish between rural claimants and others.

Sustainable Development

4.11 We do not anticipate any major sustainable development impacts from the selection of the appropriate methodology for setting the discount rate or the consequent setting of the rate. The impact of any consequent change in the discount rate may however have the indirect effect of altering insurance premiums.

Annex 1: Post Implementation Review (PIR) Plan

Basis of the review:

Legal duty to review the appropriateness of the rate on an ongoing basis. It is implicit in this duty that the method by which the rate is set should be appropriate. The methodology by which the rate is set is therefore also subject to review on an ongoing basis. Nonetheless a review can be undertaken at a fixed date.

Review objective:

Proportionate check

Review approach and rationale:

The review will consider whether the method chosen to set the discount rate as a result of the consultation has produced an accurate discount rate in accordance with section 1 of the Damages Act 1996.

Baseline:

A discount rate of 2.5% set on the basis used by Lord Irvine, the then Lord Chancellor, in 2001 and by the Scottish Justice Minister in 2002.

Success criteria:

The absence or failure of any challenge by way of judicial review to the rate or the basis on which it was set.

Monitoring information arrangements:

The financial information necessary for monitoring the appropriateness of the discount rate is publicly available.

Reasons for not planning a review:

N/A.

Appendix C – Equality Impact Assessment

Equality Impact Assessment Initial Screening – Relevance to Equality Duties

Before you complete an Equality Impact Assessment you must read the guidance notes and unless you have a comprehensive knowledge of the equality legislation and duties, it is strongly recommended that you attend an EIA training course.

The EIA should be used to identify likely impacts on:

- disability
- race
- sex
- gender reassignment
- age
- religion or belief
- sexual orientation
- pregnancy and maternity
- caring responsibilities (usually only for HR polices and change management processes such as back offices)

1. Name of the proposed new or changed legislation, policy, strategy, project or service being assessed.

How should the discount rate under section 1 of the Damages Act 1996 be set? The discount rate prescribed under section 1 is used by the court in the calculation of lump sum awards of damages in personal injury (PI) cases. These damages are intended to compensate the claimant fully for loss suffered as a result of the relevant injury, including future care costs and future loss of earnings. The application of the rate is necessary to adjust for the fact that the compensation is paid in advance as a lump sum (on the conclusion of the case) rather than when the costs or losses would actually be incurred. The present prescribed rate is 2.5%. It was set in 2001 for England, Wales and Northern Ireland and in 2002 for Scotland. Section 1(2) of the 1996 Act allows the court to apply a different rate if any party shows it is more appropriate in the case in question.

2. Individual Officer(s) & unit responsible for completing the Equality Impact Assessment.

Paul Hughes, Criminal Law and Legal Policy (in consultation with counterparts in Scotland). A separate equality impact screening has been prepared for Northern Ireland under section 75 of the Northern Ireland Act 1998 by the Department of Justice, Northern Ireland.

3. What is the main aim or purpose of the proposed new or changed legislation, policy, strategy, project or service and what are the intended outcomes?

Aims/objectives	**Outcomes**
To select and apply a methodology for setting a discount rate that is appropriate. Part of this process is to carry out a public consultation on how the discount rate should be set. The objective of the consultation is to obtain views and gather evidence as to the methodology that should be adopted and how such a methodology would be applied.	Discount rate is appropriate so that so far as possible personal injury claimants are not under-compensated or over-compensated by the payment of their future losses and expenses in a lump sum.

4. What existing sources of information will you use to help you identify the likely equality impacts on different groups of people?

As set out in the Impact Assessment, we anticipate the impact of changing the discount rate is primarily that the lump sums awarded to claimants in PI cases will change in future. At this stage we cannot predict what these new payments would be, as the methodology used to set the discount rate in future is unknown – and is the subject of the consultation. Any equality impacts will be driven by the change in lump sum payments, plus the characteristics of PI claimants receiving damages awards (and the characteristics of defendants paying damages, in the instances where defendants are individuals). We have considered law reports of decided cases about the discount rate and evidence received in response to a UK Government departmental consultation in 2001, when the rate was last changed for England, Wales and Northern Ireland. We have also considered representations received in the intervening period, notably those from the Association of Personal Injury Lawyers and the Association of British Insurers. A comprehensive evidence base does not exist in relation to the quantum of current compensation payments, and the extent to which these include future payments which would be affected by any change in the discount rate. This makes estimating the equalities impact of a change in the rate difficult. Consultation response: We will be examining the response to the consultation for evidence of any equality impacts on different groups of people. To help obtain information relating to equality impacts we have asked specific questions in the consultation paper relating to the protected characteristics.

Investment information: The discount rate is intended to represent the real rate of return on the investment of the lump sum assumed to be made by a risk-averse claimant. The same investments are available to all claimants irrespective of their personal characteristics. Nonetheless it may be the case that there should be different discount rates applied to different circumstances. If so, different groups may be affected differently. We have invited views from consultees as to whether more than one rate should be set. Information as to returns on investments is widely available and will form an important part of the consideration of the method by which the discount rate should be set.

Information about awards of damages: A lump sum award of damages is intended to provide care and compensation over the period in which it is to be invested so that the award and the income it generates is fully exhausted at the end of that period. This period will vary from case to case. We are seeking evidence from consultees as to the length of the period for which awards are made. Some information about the size of total awards and the nature of the injury to which they relate is available from published statistics, such as the Compensation Recovery unit, and the NHS Litigation Authority; some other information may be derived from departmental statistics relating, for example, of legal aid. However, this does not provide enough information to assess the equalities impacts.

Views of statutory consultees - the Lord Chancellor and the Scottish Ministers are required by section 1 to consult the Government Actuary before setting the discount rate. In addition, the Lord Chancellor must also consult the Treasury.

5. Are there gaps in information that make it difficult or impossible to form an opinion on how your proposals might affect different groups of people. If so what are the gaps in the information and how and when do you plan to collect additional information?

No comprehensive data is available on the characteristics of claimants and defendants in personal injury cases and the extent to which compensation payments include future payments which would be affected by any change in the discount rate. Without this information it is not possible to assess the impact of a change in the discount rate on different groups of people.

With the existing information, we are only able to identify that affected claimants are individuals, and defendants are more likely to be businesses (including insurance companies) and government organisations (such as the NHS). It is not known how many cases are likely to be affected, the impact to overall damages, the duration of these payments, nor the specific time profile of these. The consultation exercise seeks to gain feedback as to what the likely impacts are to claimants and defendants, including whether there are likely to be any adverse impacts on the protected equality groups.

In addition to including specific questions in the consultation relating to the protected characteristics, we are inviting consultees from a wide range of equality organisations to comment on any issues that relate to the discount rate.

We also plan to undertake additional analytical work over the consultation period,

which will explore the feasibility of reviewing datasets that potentially include settlement information. Possible sources of data include the Association of British Insurers, Association of Personal Injury Lawyers, the Compensation Recovery Unit and Health Service Litigation Authorities. Should appropriate data be accessible, we will attempt secondary analysis to see if this can inform our understanding of the impact of a change in discount rate.

We will also consider options for more proactive engagement with stakeholders. These approaches may secure views from a wider spectrum of stakeholders than relying upon formal written consultation responses alone. Such work may include telephone or face-to-face interviews with individuals from law firms, insurance companies and organisations representing the industry. Others whose views may be obtained include those who have received personal injury settlements (or those who care/support them).

6. Having analysed the initial and additional sources of information including feedback from consultation, is there any evidence that the proposed changes will have a **positive impact** on any of these different groups of people and/or promote equality of opportunity?

   Please provide details of who benefits from the positive impacts and the evidence and analysis used to identify them.

The discount rate should be set at an appropriate rate so that, as far as possible, risk-averse claimants are not under-compensated.

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.

Therefore, compared to the population as a whole those with a disability may differentially benefit from any potential positive impacts of this proposal. These would arise if the discount rate fell in future compared to the current rate. (If the rate increased, the opposite would be true.)

However, it is not clear whether particular groups of claimants will receive a more positive impact than other groups of claimants (for example, whether male claimants will benefit differentially more than female claimants). This is because while the same investments are available to all claimants, irrespective of their characteristics, we do not know the protected characteristics by the time profile of payments (for instance whether males are more likely to receive longer injury payments, and how much these might be). Certain groups may be more likely to occupy different segments of this time profile distribution and thus benefit differentially from the proposals.

We will be looking at the consultation responses and information obtained from other sources to identify any additional potential positive equalities impacts.

7. Is there any feedback or evidence that additional work could be done to promote equality of opportunity?

   If the answer is yes, please provide details of whether or not you plan to undertake this work. If not, please say why.

We are aware that there could be different discount rates applied to different circumstances. If so, different groups may be affected differently. Therefore, we have invited views from consultees as to whether more than one rate should be set. (For the purposes of the analysis contained in the Impact Assessment, it is assumed that a single rate is set.)

Furthermore, the consultation proposes two broad options relating to the methodology and how it would be applied. We are seeking consultation responses and information from other sources about potential equalities impacts for both options.

8. Is there any evidence that proposed changes will have **an adverse equality impact** on any of these different groups of people?

   Please provide details of who the proposals affect what the adverse impacts are and the evidence and analysis used to identify them.

As discussed above we do not collect equalities data on the characteristics of claimants and defendants.

As personal injury claimants may be more likely to have a disability, disabled people may benefit differentially from a reduction in the discount rate (compared to the general population). However, all claimants would benefit overall from a reduction. The opposite would be true if the discount rate increased.

However, it is not clear whether particular groups of claimants will receive a more adverse impact than other groups of claimants (for example, whether female claimants will benefit differentially more than male claimants). This is because while the same investments are available to all claimants, irrespective of their characteristics, we do not know the protected characteristics by the time profile of payments (for instance whether females are more likely to receive shorter injury payments, and how much these might be). Certain groups may be more likely to occupy different segments of this time profile distribution and thus benefit differentially from the proposals.

We will be looking at the consultation responses and information obtained from other sources to identify any additional potential positive equalities impacts.

9. Is there any evidence that the proposed changes have **no equality impacts**?

   Please provide details of the evidence and analysis used to reach the conclusion that the proposed changes have no impact on any of these different groups of people.

As set out above, it is not possible at this stage to predict what the discount rate will be in future, as the methodology that sets the discount rate is the subject of the consultation. In theory, the outcome could be that the discount rate remains at the current level, in which case there would be no equality impacts, although we do not expect this to be the case. If the rate changes, we think it unlikely that there will be no equality impacts, but will be looking at the consultation responses and information from other sources to consider further the equalities impacts.

10. Is a full Equality Impact Assessment Required? Yes ☒ No ☐

    If you answered 'No', please explain below why not?

    NOTE - You will need to complete a full EIA if:

    - the proposals are likely to have equality impacts and you will need to provide details about how the impacts will be mitigated or justified
    - there are likely to be equality impacts plus negative public opinion or media coverage about the proposed changes
    - you have missed an opportunity to promote equality of opportunity and need to provide further details of action that can be taken to remedy this

    If your proposed new or changed legislation, policy, strategy, project or service involves an Information and Communication Technology (ICT) system and you have identified equality impacts of that system, a focused full EIA for ICT specific impacts should be completed. The ICT Specific Impacts template is available from MoJ ICT or can be downloaded from the Intranet at: http://intranet.justice.gsi.gov.uk/justice/equdiv/equal-impact.htm, and should be referenced here.

We will carry out a full Equality Impact Assessment after the consultation is complete.

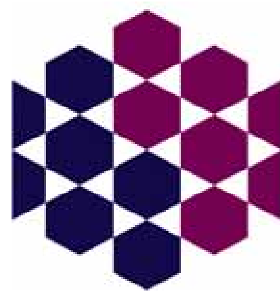
11. Even if a full EIA is not required, you are legally required to monitor and review the proposed changes after implementation to check they work as planned and to screen for unexpected equality impacts. Please provide details of how you will monitor evaluate or review your proposals and when the review will take place.

N/A

12. Name of Senior Manager and date approved

You should now complete a brief summary (if possible, in less than 50 words) **setting out which policy, legislation or service the EIA relates to, how you assessed it, a summary of the results of consultation, a summary of the impacts (positive and negative) and, any decisions made, actions taken or improvements implemented as a result of the EIA.** The summary will be published on the external MoJ website. The policy objective is to identify an appropriate methodology by which to set the discount rate applicable to lump sum personal injury awards of damages. To inform this there will be a public consultation. The consultation paper will invite views on how the rate should be set and invite evidence of the impact of the options. We will assess the equality impacts following the consultation.
Name (must be grade 5 or above): Keir Hopley
Department: Ministry of Justice
Date: 23 April 2012

Appendix D – Northern Ireland equality screening



DOJ Section 75

EQUALITY SCREENING FORM

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The Legal Background

Under section 75 of the Northern Ireland Act 1998, the Department is required **to have due regard to the need to promote equality of opportunity**:

- between person of different religious belief, political opinion, racial group, age, marital status or sexual orientation;
- between men and women generally;
- between persons with a disability and persons without; and,
- between persons with dependants and persons without.[76]

Without prejudice to the obligations set out above, the Department is also required to:

- **have regard to the desirability of promoting good relations between persons of different religious belief, political opinion or racial group; and**
- **meet legislative obligations under the Disability Discrimination Order.**

Introduction

1. This form should be read in conjunction with the Equality Commission's revised Section 75, "A Guide for Public Authorities" April 2010 and available via the following link S75 Guide for Public Authorities April 2010. **Staff should complete a form for each new or revised policy for which they are responsible (see page 6 for a definition of policy in respect of section 75).**

2. The purpose of screening is to identify those policies that are likely to have an impact on equality of opportunity and/or good relations and so determine whether an Equality Impact Assessment (EQIA) is necessary. Screening should be introduced at an early stage when developing or reviewing a policy.

3. The lead role in the screening of a policy should be taken by the policy decision-maker who has the authority to make changes to that policy and should involve, in the screening process:

   - other relevant team members;
   - those who implement the policy;
   - staff members from other relevant work areas; and
   - key stakeholders.

   A flowchart which outlines the screening process is provided at Annex A.

[76] A list of the main groups identified as being relevant to each of the section 75 categories is at Annex B of the document.

4. The first step in the screening exercise, is to gather evidence to inform the screening decisions. Relevant data may be either quantitative or qualitative or both (this helps to indicate whether or not there are likely equality of opportunity and/or good relations impacts associated with a policy). Relevant information will help to clearly demonstrate the reasons for a policy being either 'screened in' for an equality impact assessment or 'screened out' from an equality impact assessment.

5. The absence of evidence does not indicate that there is no likely impact but if none is available, it may be appropriate to consider subjecting the policy to an EQIA.

6. Screening provides an assessment of the likely impact, whether 'minor' or 'major', of its policy on equality of opportunity and/or good relations for the relevant categories. In some instances, screening may identify the likely impact is none.

7. The Commission has developed a series of four questions, included in Part 2 of this screening form with supporting sub-questions, which should be applied to all policies as part of the screening process. They identify those policies that are likely to have an impact on equality of opportunity and/or good relations.

Screening decisions

8. Completion of screening should lead to one of the following three outcomes. The policy has been:

   i. 'screened in' for equality impact assessment;

   ii. 'screened out' with mitigation or an alternative policy proposed to be adopted; or

   iii. 'screened out' without mitigation or an alternative policy proposed to be adopted.

Screening and good relations duty

9. The Commission recommends that a policy is 'screened in' for equality impact assessment if the likely impact on **good relations** is 'major'. While there is no legislative requirement to engage in an equality impact assessment in respect of good relations, this does not necessarily mean that equality impact assessments are inappropriate in this context.

PART 1

Definition of Policy

There have been some difficulties in defining what constitutes a policy in the context of section 75. To be on the safe side it is recommended that you consider any new initiatives, proposals, schemes or programmes as policies or changes to those already in existence. It is important to remember that even if a full EQIA has been carried out in an "overarching" policy or strategy, it will still be necessary for the policy maker to consider if further screening or an EQIA needs to be carried out in respect of those policies cascading from the overarching strategy.

Overview of Policy Proposals

The aims and objectives of the policy must be clear and terms of reference well defined. You must take into account any available data that will enable you to come to a decision on whether or not a policy may or may not have a differential impact on any of the s75 categories.

Policy Scoping

10. The first stage of the screening process involves scoping the policy under consideration. The purpose of policy scoping is to help prepare the background and context and set out the aims and objectives for the policy, being screened. At this stage, scoping the policy will help identify potential constraints as well as opportunities and will help the policy maker work through the screening process on a step by step basis.

11. Public authorities should remember that the Section 75 statutory duties apply to internal policies (relating to people who work for the authority), as well as external policies (relating to those who are, or could be, served by the authority).

Information about the policy

Name of the Policy
How should the discount rate under section 1 of the Damages Act 1996 be set?
The discount rate prescribed under section 1 is used by the court in the calculation of lump sum awards of damages in personal injury (PI) cases. These damages are intended to compensate the plaintiff fully for loss suffered as a result of the relevant injury, including future care costs and future loss of earnings. The application of the rate is necessary to adjust for the fact that the compensation is paid in advance as a lump sum (on the conclusion of the case) rather than when the costs or losses would actually be incurred. The rate presently prescribed for Northern Ireland is 2.5%, which was set in 2001 by the then Lord Chancellor. Section 1(2) of the 1996 Act allows the court to apply a different rate if any party shows it is more appropriate in the case in question.
Is this an existing, revised or a new policy?
Existing policy is currently under review. Prior to the devolution of justice, the Lord Chancellor had the power to set the discount rate for Northern Ireland and the then Lord Chancellor therefore determined the methodology used to set the current rate.
What is it trying to achieve? (intended aims/outcomes)
The aim is to select and apply a methodology for setting a discount rate that is appropriate and as part of this process, to carry out a public consultation on how the discount rate should be set. The objective of the consultation is to obtain views and gather evidence as to the methodology that should be adopted and how such a methodology would be applied. The intended outcome is to set a discount rate which is appropriate so that so far as possible personal injury plaintiffs are not under-compensated or over-compensated by the payment of their future losses and expenses in a lump sum.

Are there any Section 75 categories which might be expected to benefit from the intended policy? If so, explain how.
The discount rate should be set at an appropriate rate so that, as far as possible, risk-averse plaintiffs are not under-compensated. Personal injury plaintiffs 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. Therefore, compared to the population as a whole those with a disability may differentially benefit from any potential positive impacts of this proposal. These would arise if the discount rate fell in future compared to the current rate. (If the rate increased, the opposite would be true.) However it is not clear whether particular groups of plaintiffs will benefit more than other groups of plaintiffs (for example, whether male plaintiffs will benefit differentially more than female plaintiffs). This is because while the same investments are available to all plaintiffs, irrespective of their characteristics, we do not know the protected characteristics by the time profile of payments (for example, whether males are more likely to receive longer injury payments and how much these might be). Certain groups may be more likely to occupy different segments of this time profile distribution and thus benefit differentially from the proposals. We will be looking at the consultation results and information obtained from other sources to determine whether there are section 75 categories which might be expected to benefit.
Who initiated or wrote the policy?
Under the Damages Act 1996, the Department of Justice has power to set the discount rate. The Department is reviewing the current discount rate. The methodology to be used in setting the rate is being considered following advice from the Government Actuary’s Department and the Department of Finance and Personnel who are statutory consultees.
Who owns and who implements the policy?
Department of Justice owns the policy. Courts and litigants implement it.

Implementation factors

12. Are there any factors which could contribute to/detract from the intended aim/outcome of the policy/decision?

    If yes, are they

    ☒ financial

    ☐ legislative

    ☐ other, please specify ______________________________

Main stakeholders affected

13. Who are the internal and external stakeholders (actual or potential) that the policy will impact upon?

    ☐ staff

    ☒ service users

    ☒ other public sector organisations

    ☒ voluntary/community/trade unions

    ☒ other, please specify

      In particular:

      Plaintiffs and defendants in personal injury actions

      Insurance companies

      Government departments

      Judiciary

      Legal Profession

      Health and Social Care Trusts

Other policies with a bearing on this policy

- what are they?

  Reviews of the statutory discount rate in the other legal jurisdictions in the UK and associated reviews of the methodology to be used in setting the rate (although any subsequent decisions on the setting of the rate will be made independently in each jurisdiction).

- who owns them?

  Lord Chancellor (Ministry of Justice) and Scottish Ministers (Scottish Justice Department).

Available evidence

14. Evidence to help inform the screening process may take many forms. Public authorities should ensure that their screening decision is informed by relevant data.

15. What evidence/information (both qualitative and quantitative) have you gathered to inform this policy? Specify details for each of the Section 75 categories.

Section 75 Category	Details of evidence/information
Religious belief	As set out in the Impact Assessment, we anticipate the impact of changing the discount rate is primarily that the lump sums awarded to plaintiffs in PI cases will change in future. At this stage we cannot predict what these new payments would be, as the methodology used to set the discount rate in future is unknown – and is the subject of consultation. Any equality impacts will be driven by the change in lump sum payments, plus the characteristics of PI plaintiffs receiving damages awards (and the characteristics of defendants paying damages, in the instances where defendants are individuals). We have considered law reports of decided cases about the discount rate and evidence received in response to a UK Government consultation in 2001 when the current rate was set. We have also considered representations received in the intervening period, notably those from the Association of Personal Injury Lawyers and the Association of British Insurers. A comprehensive evidence base does not exist in relation to the quantum of current compensation payments and the extent to which these include future payments which would be affected by any change in the discount rate. This makes estimating the equalities impact of a change in the discount rate difficult. Consultation response – we will examine the response to the consultation for evidence of any equality impacts on the groups protected under section 75. To assist this specific questions have been asked in the paper. Investment information – the discount rate is intended to represent the real rate of return on the investment of the lump sum assumed to be made by a risk-averse plaintiff. While the same investments are available to all plaintiffs irrespective of personal characteristics, it may be the case that different

Section 75 Category	Details of evidence/information
	discount rates should be applied to different circumstances. If so, different groups may be affected differently. We have invited views from consultees as to whether more than one rate should be set. Information as to returns on investments is widely available and will form an important part of the consideration of the method by which the discount rate should be set. Information about awards of damages – a lump sum award of damages is intended to provide care and compensation over the period during which it is to be invested so that the award and the income it generates will be fully exhausted at the end of that period. This period will vary from case to case. We are seeking evidence from consultees as to the length of the period for which awards are made. While some information about the size of total awards and the injuries to which they relate is available, this is not sufficient to assess the equalities impacts. Views of statutory consultees – the Department of Justice is required to consult the Government Actuary and the Department of Finance and Personnel before setting the discount rate.
Political opinion	As above
Racial group	As above
Age	As above
Marital status	As above
Sexual orientation	As above
Men and Women generally	As above
Disability	As above
Dependants	As above

It is to be noted that no comprehensive information is available on the characteristics of plaintiffs and defendants in personal injury cases and the extent to which compensation payments include future payments which would be affected by any change in the discount rate. It is not known how many cases are likely to be affected, the

impact to overall damages, the duration of these payments, nor the specific time profile of these.

Without this information it is not possible to assess the impact of a change in the discount rate on the groups of people protected under section 75.

However the consultation exercise seeks to gain feedback as to what the likely impacts are to plaintiffs and defendants, including whether there are likely to be any adverse impacts on the groups protected under section 75. In addition to including specific questions in the consultation, we are inviting consultees from a wide range of equality organisations to comment on any issues that relate to the discount rate.

We hope to undertake additional analytical work over the consultation period, which will explore the feasibility of reviewing datasets that potentially include settlement information. Should appropriate data be accessible, we will attempt secondary analysis to see if this can inform our understanding of the impact of a change in the discount rate. We will also consider options for more proactive engagement with stakeholders.

Needs, experiences and priorities

16. Taking into account the information referred to above, what are the different needs, experiences and priorities of each of the following categories, in relation to the particular policy/decision? Specify details for each of the Section 75 categories.

As noted above, there is presently insufficient information available on the characteristics of plaintiffs and defendants to assess the impacts of a change in the discount rate on the s75 groups. While it is possible, as noted above, that certain groups, such as the disabled, may benefit differentially from a reduction in the rate (compared to the general population) all plaintiffs would benefit overall from a reduction. The opposite would be true if the discount rate increased.

We are aware that there could be different discount rates applied to different circumstances. Therefore we have invited views from consultees as to whether more than one rate should be set (For the purposes of the analysis contained in the Impact Assessment, it is assumed that a single rate is set.)

Furthermore the consultation proposes two broad options relating to the methodology and how it would be applied. We are seeking consultation responses and information from other sources about potential equalities impacts for both options.

We will be looking at the consultation responses and information obtained from other sources to identify any different needs, experiences and priorities.

Section 75 Category	Details of evidence/information
Religious belief	As above
Political opinion	As above
Racial group	As above
Age	As above
Marital status	As above
Sexual orientation	As above
Men and Women generally	As above
Disability	Subject to further assessment, personal injury plaintiffs might be more likely to suffer from a disability (as a result of an accident that is the subject of their claim) when compared to the population as a whole. As above, we will be considering the consultation responses and other sources of information.
Dependants	As above

PART 2

Screening questions

Introduction

17. In making a decision as to whether or not there is a need to carry out an equality impact assessment, consider questions 1-4 listed below.

18. If the conclusion is **none** in respect of all of the Section 75 equality of opportunity and/or good relations categories, then the decision may to screen the policy out. If a policy is 'screened out' as having no relevance to equality of opportunity or good relations, give details of the reasons for the decision taken.

19. If the conclusion is **major** in respect of one or more of the Section 75 equality of opportunity and/or good relations categories, then consideration should be given to subjecting the policy to the equality impact assessment procedure.

20. If the conclusion is **minor** in respect of one or more of the Section 75 equality categories and/or good relations categories, then consideration should still be given to proceeding with an equality impact assessment, or to:
    - measures to mitigate the adverse impact; or
    - the introduction of an alternative policy to better promote equality of opportunity and/or good relations.

In favour of a 'major' impact

21 (a) The policy is significant in terms of its strategic importance;

(b) Potential equality impacts are unknown, because, for example, there is insufficient data upon which to make an assessment or because they are complex, and it would be appropriate to conduct an equality impact assessment in order to better assess them;

(c) Potential equality and/or good relations impacts are likely to be adverse or are likely to be experienced disproportionately by groups of people including those who are marginalised or disadvantaged;

(d) Further assessment offers a valuable way to examine the evidence and develop recommendations in respect of a policy about which there are concerns amongst affected individuals and representative groups, for example in respect of multiple identities;

(e) The policy is likely to be challenged by way of judicial review;

(f) The policy is significant in terms of expenditure.

In favour of 'minor' impact

22 (a) The policy is not unlawfully discriminatory and any residual potential impacts on people are judged to be negligible;

(b) The policy, or certain proposals within it, are potentially unlawfully discriminatory, but this possibility can readily and easily be eliminated by making appropriate changes to the policy or by adopting appropriate mitigating measures;

(c) Any asymmetrical equality impacts caused by the policy are intentional because they are specifically designed to promote equality of opportunity for particular groups of disadvantaged people;

(d) By amending the policy there are better opportunities to better promote equality of opportunity and/or good relations.

In favour of none

23 (a) The policy has no relevance to equality of opportunity or good relations.

(b) The policy is purely technical in nature and will have no bearing in terms of its likely impact on equality of opportunity or good relations for people within the equality and good relations categories.

24. Taking into account the evidence presented above, consider and comment on the likely impact on equality of opportunity and good relations for those affected by this policy, in any way, for each of the equality and good relations categories, by applying the screening questions given overleaf and indicate the level of impact on the group i.e. minor, major or none.

Screening questions

1.	What is the likely impact on equality of opportunity for those affected by this policy, for each of the Section 75 equality categories?
	Minor/Major/None Please see information above regarding section 75 categories that might be expected to benefit from the intended policy. We will be looking at the consultation responses and other sources of information to identify any potential impact on equality of opportunity and the level of any impact in this regard.

Section 75 category	**Details of policy impact**	**Level of impact? Minor/Major/None**
Religious belief	As above	As above
Political opinion	As above	As above
Racial group	As above	As above

Section 75 category	Details of policy impact	Level of impact? Minor/Major/None
Age	As above	As above
Marital status	As above	As above
Sexual orientation	As above	As above
Men and Women generally	As above	As above
Disability	Subject to further assessment, personal injury plaintiffs might be more likely to suffer from a disability (as a result of an accident that is the subject of their claim) when compared to the population as a whole. As above, we will be considering the consultation responses and other sources of information.	As above
Dependants	As above	As above

2.	Are there opportunities to better promote equality of opportunity for people within the Section 75 equalities categories?
	As noted above, we are aware that there could be different discount rates applied to different circumstances and we have invited views from consultees as to whether more than one rate should be set. As also noted above, the consultation proposes two broad options relating to the methodology and how it would be applied and we are seeking consultation responses and information from other sources about potential equalities impacts for both options.

Section 75 category	If Yes, provide details	If No, provide reasons
Religious belief	See above	See above
Political opinion	See above	See above
Racial group	See above	See above

Section 75 category	**If Yes, provide details**	**If No, provide reasons**
Age	See above	See above
Marital status	See above	See above
Sexual orientation	See above	See above
Men and Women generally	See above	See above
Disability	Subject to further assessment, personal injury plaintiffs might be more likely to suffer from a disability (as a result of an accident that is the subject of their claim) when compared to the population as a whole. As above, we will be considering the consultation responses and other sources of information.	See above
Dependants	See above	See above

3. To what extent is the policy likely to impact on good relations between people of different religious belief, political opinion or racial group?
Minor/Major/None

Good relations category	**Details of policy impact**	**Level of impact Minor/Major/None**
Religious belief		None
Political opinion		None
Racial group		None

4. Are there opportunities to better promote good relations between people of different religious belief, political opinion or racial group?		
Good relations category	**If Yes, provide details**	**If No, provide reasons**
Religious belief		No given nature of policy
Political opinion		No given nature of policy
Racial group		No given nature of policy

Additional considerations

Multiple identity

25. Generally speaking, people can fall into more than one Section 75 category. Taking this into consideration, are there any potential impacts of the policy/decision on people with multiple identities?

    We will be considering the consultation responses and information from other sources to identify any potential impacts on people with multiple identities.

    (For example; disabled minority ethnic people; disabled women; young Protestant men; and young lesbians, gay and bisexual people).

26. Provide details of data on the impact of the policy on people with multiple identities. Specify relevant Section 75 categories concerned.

    No relevant data is available but as noted above we will be considering the consultation responses and information from other sources.

PART 3

Screening decision

27. If the decision is not to conduct an equality impact assessment, please provide details of the reasons.

A decision whether to conduct an equality impact assessment will be determined upon consideration of the consultation responses and information from other sources and further assessment of the equality impacts.

28. If the decision is not to conduct an equality impact assessment, consider if the policy should be mitigated or an alternative policy be introduced.

29. If the decision is to subject the policy to an equality impact assessment, please provide details of the reasons.

30. Further advice on equality impact assessment may be found in a separate Commission publication: Practical Guidance on Equality Impact Assessment.

Mitigation

31. When the public authority concludes that the likely impact is 'minor' and an equality impact assessment is not to be conducted, the public authority may consider mitigation to lessen the severity of any equality impact, or the introduction of an alternative policy to better promote equality of opportunity or good relations.

32. Can the policy/decision be amended or changed or an alternative policy introduced to better promote equality of opportunity and/or good relations?

33. If so, give the **reasons** to support your decision, together with the proposed changes/amendments or alternative policy.

Timetabling and prioritising

34. Factors to be considered in timetabling and prioritising policies for equality impact assessment.

35. If the policy has been **'screened in'** for equality impact assessment, then please answer the following questions to determine its priority for timetabling the equality impact assessment.

36. On a scale of 1-3, with 1 being the lowest priority and 3 being the highest, assess the policy in terms of its priority for equality impact assessment.

Priority criterion	**Rating (1-3)**
Effect on equality of opportunity and good relations	
Social need	
Effect on people's daily lives	
Relevance to a public authority's functions	

37. Note: The Total Rating Score should be used to prioritise the policy in rank order with other policies screened in for equality impact assessment. This list of priorities will assist the public authority in timetabling. Details of the Public Authority's Equality Impact Assessment Timetable should be included in the quarterly Screening Report.

38. Is the policy affected by timetables established by other relevant public authorities?

39. If yes, please provide details.

PART 4

Monitoring

40. Public authorities should consider the guidance contained in the Commission's Monitoring Guidance for Use by Public Authorities (July 2007).

41. The Commission recommends that where the policy has been amended or an alternative policy introduced, the public authority should monitor more broadly than for adverse impact (See Benefits, P.9-10, paras 2.13 – 2.20 of the Monitoring Guidance).

42. Effective monitoring will help the public authority identify any future adverse impact arising from the policy which may lead the public authority to conduct an equality impact assessment, as well as help with future planning and policy development.

PART 5

Approval and authorisation

Screened by:	**Position/Job Title**	**Date**
Jane Maguire	Principal Legal Officer Civil Policy & Legislation	26 April 2012
Jo Wilson	Principal Legal Officer Civil Policy & Legislation	26 April 2012
Michael Kelly	Principal Legal Officer Criminal Policy & Legislation	26 April 2012
Approved by:		
Siobhan Broderick	Deputy Director Civil Policy and Legislation	26 April 2012

Note: A copy of the Screening Template, for each policy screened should be 'signed off' and approved by a senior manager responsible for the policy, made easily accessible on the public authority's website as soon as possible following completion and made available on request.

The Screening exercise is now complete.

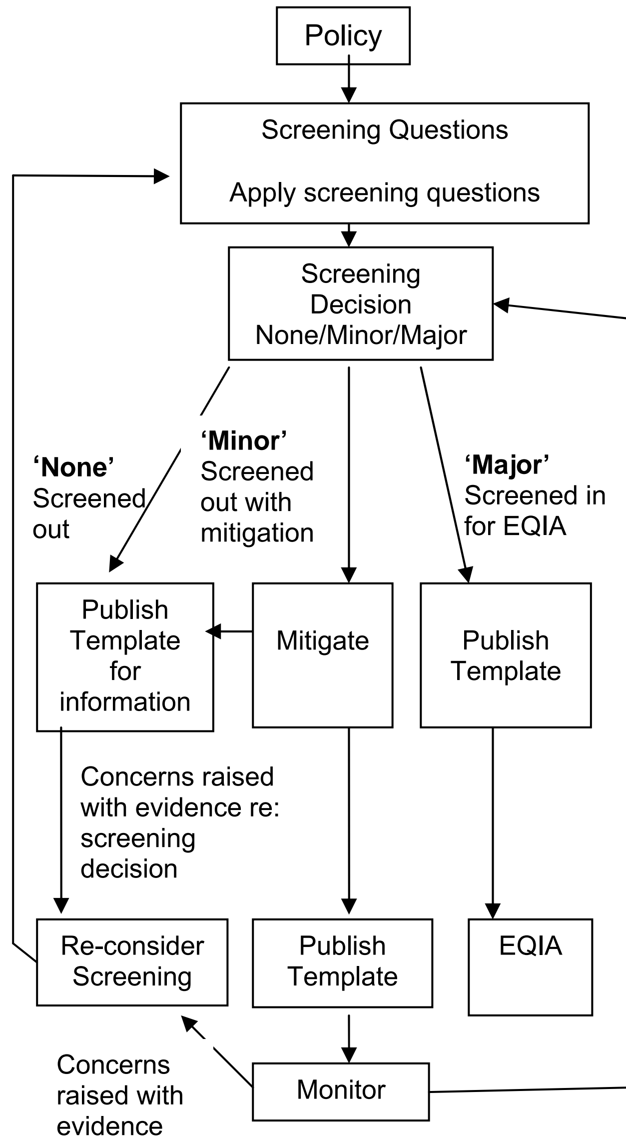
When you have completed the form please retain a record in your branch and send a copy for information to:

Central Management Unit
Room A4.2
Castle Buildings
Stormont Estate
BELFAST
BT4 3SG

or e-mail to Mark Higgins mark.higgins@dojni.x.gsi.gov.uk; or Karen Dalzell karen.dalzell@dojni.x.gsi.gov.uk.

ANNEX A

Screening flowchart



ANNEX B

Main groups identified as relevant to the Section 75 categories

Category	Main Groups
Religious Belief	Protestants; Catholics; people of other religious belief; people of no religious belief
Political Opinion	Unionists generally; Nationalists generally; members/supporters of any political party
Racial Group	White people; Chinese; Irish Travellers; Indians; Pakistanis; Bangladeshis; Black Africans; Afro Caribbean people; people of mixed ethnic group, other groups
Age	For most purposes, the main categories are: children under 18; people aged between 18 and 65. However the definition of age groups will need to be sensitive to the policy under consideration. For example, for some employment policies, children under 16 could be distinguished from people of working age
Marital/Civil Partnership Status	Married people; unmarried people; divorced or separated people; widowed people; civil partnerships
Sexual Orientation	Heterosexuals; bisexual people; gay men; lesbians
Men and Women generally	Men (including boys); women (including girls); trans-gender and trans-sexual people
Persons with a disability and persons without	Persons with a physical, sensory or learning disability as defined in Schedules 1 and 2 of the Disability Discrimination Act 1995.
Persons with dependants and persons without	Persons with primary responsibility for the care of a child; persons with personal responsibility for the care of a person with a disability; persons with primary responsibility for a dependent elderly person.

The consultation criteria

The seven consultation criteria are as follows:

1. **When to consult** – Formal consultations should take place at a stage where there is scope to influence the policy outcome.

2. **Duration of consultation exercises** – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. **Clarity of scope and impact** – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

4. **Accessibility of consultation exercises** – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. **The burden of consultation** – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

6. **Responsiveness of consultation exercises** – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

7. **Capacity to consult** – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

These criteria must be reproduced within all consultation documents.

Consultation Co-ordinator contact details

Responses to the consultation must go to the named contact under the How to Respond section.

However, if you have any complaints or comments about the consultation **process** you should contact the Ministry of Justice consultation co-ordinator at consultation@justice.gsi.gov.uk.

Alternatively, you may wish to write to the address below:

Ministry of Justice Consultation Co-ordinator
Better Regulation Unit
Analytical Services
Ministry of Justice
Pillar 7:02
102 Petty France
London SW1 9AJ

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Alternative format versions of this report are available on request from 020 3334 6964 or damagesdiscountrate@justice.gsi.gov.uk.