



Ministry  
of Justice

# **The Personal Injury Discount Rate**

How it should be set in future

Draft Legislation

September 2017

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Draft Legislation

Ministry of Justice

Presented to Parliament

by the Lord Chancellor and Secretary of State for Justice  
by Command of Her Majesty

September 2017



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## Foreword

Awards of damages for life changing personal injuries should fully compensate the financial losses and expenses caused by the injury. Calculating the present cost of future losses is inevitably an inexact science, but in assessing the size of a lump sum payment of damages for future costs the law must do its best to anticipate the amount that is needed now to produce all the money that is expected to be required by the injured person in the future when it is expected to be needed. These sums are necessarily going to be very large in some cases, but, however much money is involved, the underlying principles are the same. Awards of damages should provide full compensation, neither more nor less.

Following the consultation initiated by my immediate predecessor as Lord Chancellor in March 2017, the Government has concluded that the law on how the discount rate is set is not working as fairly as it should. The Government's response to the consultation, which is being published alongside this paper, describes the reforms that the Government thinks necessary.

Setting the "right" discount rate at any time is not a straightforward exercise. It is important that the law is not only technically correct, accurate and workable, but also that it creates a system that is understandable and transparent in its workings. Government wants to create a system that is fair. I believe that when enacted the draft provisions will achieve this, but to make sure the reforms are as good as they can be I am giving experts and interested parties the chance to scrutinise the proposals before they are introduced into Parliament.

I am therefore taking this opportunity to invite comments on the draft discount rate legislation that we have prepared to implement our proposals. I welcome responses from everyone interested in this topic.

Subject to the response to the draft legislation, the Government intends to legislate promptly to make sure that the way the rate is set is put on the best possible footing at the earliest practicable date so that we have a better and fairer system for claimants, defendants and society as a whole.

Rt Hon David Lidington MP

Lord Chancellor and Secretary of State for Justice

## **Introduction**

This document sets out draft legislation to implement the Government's proposed reforms to the law governing the way that the personal injury discount rate is set in England and Wales. The publication of the draft legislation accompanies the publication of the post-consultation report for the consultation paper, 'The Personal Injury Discount Rate: How it should be set in future'.

The document invites views on the draft legislation and contains:

- the background to the draft legislation;
- a summary of the proposals;
- a description of next steps;
- the text of the draft legislation; and
- draft explanatory notes to accompany the draft clause.

An impact assessment and equality statement are being published alongside this paper.

## Background

The consultation paper 'The Personal Injury Discount Rate: How it should be set in future' was published jointly by the Ministry of Justice and the Scottish Government on 30 March 2017. The paper invited comments on how the personal injury discount rate - the rate taken into account by a court in assessing the size of a lump sum award of damages for future financial loss - should be set in England and Wales, and in Scotland.

The core issues examined in the consultation paper were:

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

The paper also considered whether sufficient use is being made of periodical payment orders.

The consultation period closed on 11 May. The responses to the consultation are summarised in the post-consultation report for the consultation paper, 'The Personal Injury Discount Rate: How it should be set in future' published alongside this document. The post-consultation report also includes a summary of the Government's proposals for the reform of the law and an Equalities Statement.

The Government's proposals relate only to England and Wales.

The draft provisions have been prepared to give effect to the Government's proposals. They are being published to give interested parties an opportunity to comment on the detail of the proposed legislation. The draft clause is at Annex A. Explanatory Notes to accompany the clause are at Annex B.

The Impact Assessment and Equalities Statement accompanying the consultation were updated to take account of evidence provided by stakeholders during the consultation period.

The consultation response and the Impact Assessment refer to reports prepared for the Ministry of Justice by the Government Actuary's Department and the British Institute of International and Comparative Law. These reports are being published alongside this paper.

All the above documents are available at: <https://www.gov.uk/government/consultations/personal-injury-discount-rate-how-it-should-be-set-in-future>

A Welsh language version of the summary of proposals section of this document will be made available at <http://www.justice.gov.uk/publications/corporate-reports/moj/2010/welsh-language-scheme>

## Summary of proposals

1. Following the announcement of a change of rate and proposed consultation on 27 February the then Lord Chancellor said:

The Government will review the framework under which I have set the rate today to ensure that it remains fit for purpose in the future. I will bring forward a consultation before Easter that will consider options for reform including: whether the rate should in future be set by an independent body; whether more frequent reviews would improve predictability and certainty for all parties; and whether the methodology – which in effect assumes that claimants would invest only in index-linked gilts – is appropriate for the future. Following the consultation, which will consider whether there is a better or fairer framework for claimants and defendants, the Government will bring forward any necessary legislation at an early stage.

2. The Government has consulted and carefully considered the responses. It now intends to bring forward legislation to create a fairer and better system for the setting of the discount rate, but before doing so wishes to provide an opportunity for interested parties to comment on the details of the proposed legislation.
3. The proposals do not affect the underlying principle of the law of damages, which is that claimants should be compensated in full for the losses they have suffered because of the injury caused by the defendant. The objective of applying a discount rate will therefore continue to be to support a 100% compensation rule so that claimants receive full compensation for the loss caused by the wrongful injury neither more nor less.
4. The consultation paper addressed the issues relating to the setting of the discount rate by reference to the key subject areas of how, when and by whom the rate should be set.
5. As is described in the response document, the responses contained a wide range of, often divided, opinion. Overall, the responses revealed a general dissatisfaction with various aspects of the present law for a range of reasons but no strong consensus across the different interest groups as to how the law should specifically be reformed other than in a small number of limited areas, such as the need for more frequent reviews in the future than occurred in the past and the desirability of retaining the present balance between lump sum awards and periodical payment orders.
6. **On how the rate should be set**, the consultation responses were divided as to the investment risk appetite that should be assumed in the setting of the rate (claimant interests generally favouring the present very low risk level and defendants a higher, but still low, risk level). There was, however, widespread agreement that claimants should be treated as more risk averse than ordinary prudent investors. Subject to this difference of opinion there was wide support for the general principles proposed for

the setting of the rate.<sup>1</sup> It was also clear, taking the responses and the results of other research together, that claimants invest in low risk diversified portfolios not in “very low risk” investments, such as Index Linked Gilts (“ILGs”) alone.

7. Based on the evidence and analysis, which is explained in the Impact Assessment, we believe the assumptions made by the present law on the setting of the discount rate as to how claimants invest are unrealistic and, as it stands, the rate may produce significantly larger awards than provide 100% compensation. The unrealistic assumptions currently being used are having a significant effect on taxpayers through the additional cost of personal injury settlements paid by the National Health Service and other public sector bodies; and businesses and individual consumers through insurance premiums that are higher because awards of damages may be providing more than 100% compensation. The framework for setting the discount rate therefore needs to be re-calibrated to help it better achieve its objective of 100% compensation.
8. **On when the rate should be reviewed** there was general agreement that reviews should occur more frequently than previously and with greater predictability, but a range of views on what the appropriate period should be and whether it should be fixed.
9. **As to who should set the rate**, there was support for introducing more independent expertise and transparency into the process for the setting of the rate, but whilst some respondents favoured an independent panel setting the rate, defendants generally argued for political control of the final decision albeit with advice from an independent panel. The Government acknowledges the general support for an independent expert panel to be involved in the process of setting the rate. However, the Government also accepts the importance of providing clear political accountability for a decision, which whilst only exercisable within the constraints of the law, has important financial and fiscal consequences.
10. In the light of this response and its own consideration of the issues, the Government has concluded that there is clearly a need for a fairer and better framework for the setting of the discount rate. The Government therefore intends to make the following changes to the law.
11. **On how the rate should be set**, the proposed legislation specifies that the rate is to be set by reference to expected rates of return on a low risk diversified portfolio of

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<sup>1</sup> Paragraph 36 of the Consultation Paper proposed the following general principles: “The general principles for setting the rate might be as follows:

The discount rate should be the rate that in the reasonable opinion of the setter is (a) consistent with the returns expected from the investment strategy implied by the appropriate risk profile of the claimant (see below) and (b) satisfies the following:

- the lump sum payable after the application of the discount rate plus the assumed income expected to be earned should represent the full loss, neither more nor less, caused by the wrongful injury;
- the losses and costs assessed by the court to flow from the injury should be met on time; and
- the capital and the income assumed to be earned from the award must be exhausted at the end of the period for which the award is made.

Due regard should be given for the following factors:

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

investments rather than very low risk investments as at present. In assessing those rates the actual investment practices of claimants and the investments available to them should be considered. This will make the rate more realistic and better reflect how claimants invest their awards in practice. It will continue to be possible to set different rates for different types of cases, including by reference to the length of the award.

12. Under the new law the discount rate will reflect the rate of return to be expected on a low risk diversified portfolio. There will probably be a range of portfolios and rates of return that might be used in the setting of the rate. It will be for the Lord Chancellor to apply the legal principles set out in the legislation and on that basis to decide where in the range of low risk the rate should be set.
13. The key legal principle will be that the rate should be the rate that, in the reasonable opinion of the Lord Chancellor, a properly advised recipient of a lump sum of damages for future financial loss could be expected to achieve if he or she invested the lump sum in a diversified low risk portfolio with the aim of securing that (a) the lump sum and the income from it would meet the losses and costs for which they are awarded when are expected to fall; and (b) the relevant damages would be exhausted at the end of the period for which they are awarded. In this exercise the Lord Chancellor must consider the investments available and actual investments made by claimants; and must make such allowances for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate.
14. **On when the rate should be reviewed** the proposed legislation provides that the rate is initially to be reviewed promptly after the legislation comes into force and, thereafter, at least every three years, with that period being re-set when the rate is changed. The initial review is to be commenced within 90 days of the provisions coming into force. All reviews will be completed within 180 days of starting. A new rate will then be set if a change is considered by the Lord Chancellor to be appropriate. The new rate will come into force on a date to be fixed by the Lord Chancellor. This will avoid overlong delays between reviews, which will make changes in the rate more predictable and manageable.
15. **As to who should set the rate**, the draft legislation provides that the rate is to be set by the Lord Chancellor after consulting an expert panel (other than on the initial review which will be by the Lord Chancellor with advice from the Government Actuary). HM Treasury will, as at present, also be a statutory consultee at all reviews. The panel will be chaired by the Government Actuary and include four other members having experience as an actuary, an investment manager and an economist and, finally, in consumer investment affairs.
16. The draft clause to give effect to these changes is set out at Annex A.
17. The Government believes that these changes will make a fairer and better system for the setting of the discount rate. Claimants will continue to receive full and fair compensation, but by aligning the discount rate to how claimants invest in practice defendants and their insurers will no longer pay greater than 100% compensation because of the application of an artificially low discount rate. Changes to the rate will be informed by a broader range of expertise and be carried out in a more transparent manner than in the past. Sizeable shifts in the rate should be avoided by more frequent reviews, which will lead to the rate being aligned with returns from

investments more often and avoid the potential “shock” to the financial system of substantial changes in the rate for which the market is unprepared.

18. The effect of the draft legislation is more fully explained in the draft explanatory notes prepared to accompany the draft clause at Annex B.

### **Extent of application of the proposed legislation and devolution**

19. The draft legislation relates only to England and Wales. The purpose of the legislation relates to civil claims under the law of tort and awards of damages. This is not an area of which the National Assembly for Wales or the Welsh Government has or will have competence at present or under the amendments made to the Government of Wales Act 2006 by the Wales Act 2017.
20. The Damages Act 1996, which will be amended by the draft legislation when it is enacted, does, however, relate to the whole of the United Kingdom. As the amendments to be effected by the draft legislation insert a new Schedule into the Act references to the existing schedule as “The Schedule” will have to be amended to refer to “Schedule 1”. The schedule in question relates only to the law of Northern Ireland.

### **Delegated powers in the proposed legislation**

21. The draft legislation contains no new delegated powers. It does, however, carry forward two delegated powers to make secondary legislation. These are the power for the Lord Chancellor to specify the rate in a statutory instrument, and the requirement on the court to take the rate prescribed by the Lord Chancellor into account subject to and in accordance with any rules of court made for this purpose. These continuing provisions will be subject to the changes in the surrounding law made by the draft legislation (e.g. the new time limits for the holding of reviews).

### **Commencement of the proposed legislation**

22. The amendments to the Damages Act 1996 are expected to be brought into effect in the usual way on a date to be fixed by commencement order made by the Lord Chancellor in due course. Any change in the rate made under the new provisions will not affect awards of damages already made, but will from the date the change comes into force be taken into account by the courts in assessing the rate of return to be expected from the sum awarded in place of the previously applicable rate. This continues the approach of the present law. There is no retrospective effect.

### **Human Rights Act 1998**

23. The Government considers that the changes proposed do not engage any of the Convention Rights as defined in the Human Rights Act 1998 and that they are therefore compatible with the Convention Rights.

## Impact of the proposed legislation

24. The discount rate has important financial and economic effects. The Government's assessment of the effect of introducing the new legal framework set out in the draft clause is explained in the Impact Assessment and Equalities Statement published alongside this paper.<sup>2</sup> The Government would welcome further evidence to consider in preparing the Impact Assessment and Equalities Statement to accompany the proposed legislation when it is introduced into Parliament.
25. These assessments relate to the overall framework for the assessment of the rate. They do not assess the impact of a particular change in the rate. The rate may go up or down by varying amounts depending on the circumstances at the time of the review. Reviews may also occur more frequently than the maximum intervals specified in the draft legislation.
26. The first review of the rate under the proposed new law will not occur until the legislation has been enacted. It is not possible to predict what specific rate a review under the new approach would produce.
27. Nonetheless, broadly speaking, based on the evidence currently available and without fettering the exercise of the Lord Chancellor's discretion in the future, the Government would expect that if a single rate were set today under the new approach the real rate might fall within the range of 0% to 1%.
28. This estimate of what the range of rates might be under the proposed law is primarily based on the expected returns over longer award periods, contained in the report from the Government Actuary's Department published alongside this paper, and has been reached by making illustrative assumptions as to appropriate allowances for investment expenses and taxation. If return expectations reduce or the assumptions for investment expenses and taxation turn out to be under-estimates, the rate may be lower; or, if return expectations increase or the assumptions turn out to be over-estimates, higher. The estimated rate also reflects the new assumption that claimants are to be assumed to be prepared to take a low level of investment risk. This assumption aligns with the evidence collected during the consultation on how claimants invest their awards in practice. Low risk is not a precise term and covers a range of possibilities, which would be expected to produce different investment outcomes at different discount rates. This is discussed in the Government Actuary's Department's report.

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<sup>2</sup> <https://www.gov.uk/government/consultations/personal-injury-discount-rate-how-it-should-be-set-in-future>

## **Next steps**

29. The Government invites comments on the draft legislation.
30. Subject to considering these comments the Government intends to introduce legislation into Parliament to enact these proposed changes to the law as soon as parliamentary time permits. Once enacted the changes will be brought into force on a date to be specified by the Lord Chancellor.

## Annex A – Draft Clause

### 1 Assumed rate of return on investment of damages

- (1) Before section 1 of the Damages Act 1996 (assumed rate of return on investment of damages) insert—

**“A1 Assumed rate of return on investment of damages: England and Wales**

- (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 must, 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) does 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) may prescribe different rates of return for different classes of case.
- (4) Schedule A1 (which makes provision about determining the rate of return to be prescribed by an order under subsection (1)) has effect.
- (5) An order under this section is to be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.”
- (2) Before the Schedule to the Damages Act 1996 insert—

**“SCHEDULE A1**

**ASSUMED RATE OF RETURN ON INVESTMENT OF DAMAGES: ENGLAND AND WALES**

*Periodic reviews of the rate of return*

- 1 (1) The Lord Chancellor must review the rate of return periodically in accordance with this paragraph.
- (2) A review of the rate of return must be started within the 90 day period following commencement.
- (3) A review of the rate of return must be started within the 3 year period following the last review.
- (4) It is for the Lord Chancellor to decide—
- (a) when, within the 90 day period following commencement, a review under sub-paragraph (2) is to be started;
- (b) when, within the 3 year period following the last review, a review under sub-paragraph (3) is to be started.
- (5) In this paragraph—

“90 day period following commencement” means the period of 90 days beginning with the day on which this paragraph comes into force;

“3 year period following the last review” means the period of three years beginning with the day on which the last review under this paragraph (whether under sub-paragraph (2) or (3)) is concluded.

- (6) For the purposes of this paragraph a review is concluded on the day when the Lord Chancellor makes a determination under paragraph 2 or 3 (as the case may be) as a result of the review.

*Determining the rate of return on the first review*

- 2 (1) This paragraph applies whenever the Lord Chancellor is required by paragraph 1(2) to conduct a review of the rate of return.
- (2) The Lord Chancellor must review the rate of return and determine whether it should be—
- (a) changed to a different rate, or
  - (b) kept unchanged.
- (3) The Lord Chancellor must conduct that review and make that determination within the 180 day review period.
- (4) In conducting the review, the Lord Chancellor must consult—
- (a) the Government Actuary, and
  - (b) the Treasury.
- (5) The Government Actuary must respond to the consultation within the period of 90 days beginning with the day on which the Government Actuary’s response to the consultation is requested.
- (6) The exercise of the power of the Lord Chancellor under this paragraph to determine whether the rate of return should be changed or kept unchanged is subject to paragraph 4.
- (7) When deciding what response to give to the Lord Chancellor under this paragraph, the Government Actuary and the Treasury must take into account the duties imposed on the Lord Chancellor by paragraph 4.
- (8) During any period when the office of Government Actuary is vacant, a reference in this paragraph to the Government Actuary is to be read as a reference to the Deputy Government Actuary.
- (9) In this paragraph “180 day review period” means the period of 180 days beginning with the day which the Lord Chancellor decides (under paragraph 1) to be the day on which the review is to start.

*Determining the rate of return on later reviews*

- 3 (1) This paragraph applies whenever the Lord Chancellor is required by paragraph 1(3) to conduct a review of the rate of return.
- (2) The Lord Chancellor must review the rate of return and determine whether it should be—
- (a) changed to a different rate, or
  - (b) kept unchanged.
- (3) The Lord Chancellor must conduct that review and make that determination within the 180 day review period.

- (4) In conducting the review, the Lord Chancellor must consult—
  - (a) the expert panel established for the review, and
  - (b) the Treasury.
- (5) The expert panel must respond to the consultation within the period of 90 days beginning with the day on which their response to the consultation is requested.
- (6) The exercise of the power of the Lord Chancellor under this paragraph to determine whether the rate of return should be changed or kept unchanged is subject to paragraph 4.
- (7) When deciding what response to give to the Lord Chancellor under this paragraph, the expert panel and the Treasury must take into account the duties imposed on the Lord Chancellor by paragraph 4.
- (8) In this paragraph “180 day review period” means the period of 180 days beginning with the day which the Lord Chancellor decides (under paragraph 1) to be the day on which the review is to start.

*Determining the rate of return*

- 4 (1) The Lord Chancellor must comply with this paragraph when determining under paragraph 2 or 3 whether the rate of return should be changed or kept unchanged (“the rate determination”).
- (2) The Lord Chancellor must make the rate determination on the basis that the rate of return should be the rate that, in the opinion of the Lord Chancellor, a recipient of relevant damages could reasonably be expected to achieve if he or she invested the relevant damages for the purpose of securing that—
  - (a) the relevant damages would meet the losses and costs for which they are awarded;
  - (b) the relevant damages would meet those losses and costs at the time or times when they fall to be compensated; and
  - (c) the relevant damages would be exhausted at the end of the period for which they are awarded.
- (3) In making the rate determination as required by sub-paragraph (2), the Lord Chancellor must make the following assumptions—
  - (a) the assumption that the relevant damages are payable in a lump sum (rather than under a periodic payments order);
  - (b) the assumption that the recipient of the relevant damages is properly advised on the investment of the relevant damages;
  - (c) the assumption that the recipient of the relevant damages invests the relevant damages in a diversified portfolio of investments;
  - (d) the assumption that the relevant damages are invested using an approach that involves—
    - (i) more risk than a very low level of risk, but
    - (ii) less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.
- (4) That does not limit the assumptions which the Lord Chancellor may make.

- (5) In making the rate determination as required by sub-paragraph (2), the Lord Chancellor must—
  - (a) have regard to the actual returns that are available to investors;
  - (b) have regard to the actual investments made by investors of relevant damages; and
  - (c) make such allowances for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate.
- (6) That does not limit the factors which may inform the Lord Chancellor when making the rate determination.
- (7) The Lord Chancellor must give reasons for the decisions made on the matters mentioned in sub-paragraph (5)(c).
- (8) In this paragraph “relevant damages” means a sum awarded as damages for future pecuniary loss in an action for personal injury.

*Expert panel*

- 5 (1) For each review of a rate of return, the Lord Chancellor is to establish a panel (referred to in this Schedule as an “expert panel”) consisting of—
  - (a) the Government Actuary, who is to chair the panel; and
  - (b) four other members appointed by the Lord Chancellor.
- (2) The Lord Chancellor must exercise the power to appoint the appointed members to secure that—
  - (a) one appointed member has experience as an actuary;
  - (b) one appointed member has experience of managing investments;
  - (c) one appointed member has experience as an economist;
  - (d) one appointed member has experience in consumer matters as relating to investments.
- (3) An expert panel established for a review of a rate of return ceases to exist once it has responded to the consultation relating to the review.
- (4) A person may be a member of more than one expert panel at any one time.
- (5) A person may not become an appointed member if he or she is ineligible for membership.
- (6) An appointed member ceases to be a member if he or she becomes ineligible for membership.
- (7) The Lord Chancellor may end an appointed member’s membership of the panel if the Lord Chancellor is satisfied that—
  - (a) the person is unable or unwilling to take part in the panel’s activities on a review conducted under paragraph 1;
  - (b) it is no longer appropriate for the person to be a member of the panel because of gross misconduct or impropriety;
  - (c) the person has become bankrupt, a debt relief order (under Part 7A of the Insolvency Act 1986) has been made in respect of the person, the person’s estate has been sequestrated or the person has made an arrangement with or granted a trust deed for creditors.

- (8) During any period when the office of Government Actuary is vacant the Deputy Government Actuary is to be a member of the panel and is to chair it.
- (9) A person is “ineligible for membership” of an expert panel if he or she is—
  - (a) a Minister of the Crown, or
  - (b) a person serving in a government department in employment in respect of which remuneration is payable out of money provided by Parliament.
- (10) In this paragraph “appointed member” means a person appointed by the Lord Chancellor to be a member of an expert panel.

*Proceedings, powers and funding of an expert panel*

- 6 (1) The quorum of an expert panel is three members, one of whom must be the Government Actuary (or the Deputy Government Actuary when the office of Government Actuary is vacant).
- (2) In the event of a tied vote on any decision, the person chairing the panel is to have a second casting vote.
- (3) The panel may—
  - (a) invite other persons to attend, or to attend and speak at, any meeting of the panel;
  - (b) when exercising any function, take into account information submitted by, or obtained from, any other person (whether or not the production of the information has been commissioned by the panel).
- (4) The Lord Chancellor must make arrangements for an expert panel to be provided with the resources which the Lord Chancellor considers to be appropriate for the panel to exercise its functions.
- (5) The Government Actuary’s Department, or any other government department, may enter into arrangements made by the Lord Chancellor under sub-paragraph (4).
- (6) The Lord Chancellor must make arrangements for the appointed members of an expert panel to be paid any remuneration and expenses which the Lord Chancellor considers to be appropriate.

*Application of this Schedule where there are several rates of return*

- 7 (1) This paragraph applies if two or more rates of return are prescribed under section A1.
- (2) The requirements—
  - (a) under paragraph 1 for a review to be conducted, and
  - (b) under paragraph 2 or 3 relating to how a review is conducted, apply separately in relation to each rate of return.
- (3) As respects a review relating to a particular rate of return, a reference in this Schedule to the last review conducted under a particular provision is to be read as a reference to the last review relating to that rate of return.

*Interpretation*

- 8 (1) In this Schedule—
- “expert panel” means a panel established in accordance with paragraph 5;
  - “rate of return” means a rate of return for the purposes of section A1.
- (2) A provision of this Schedule that refers to the rate of return being changed is to be read as also referring to—
- (a) the existing rate of return being replaced with no rate;
  - (b) a rate of return being introduced where there is no existing rate;
  - (c) the existing rate of return for a particular class of case being replaced with no rate;
  - (d) a rate of return being introduced for a particular class of case for which there is no existing rate.
- (3) A provision of this Schedule that refers to the rate of return being kept unchanged is to be read as also referring to—
- (a) the position that there is no rate of return being kept unchanged;
  - (b) the position that there is no rate of return for a particular class of case being kept unchanged.
- (4) A provision of this Schedule that refers to a review of the rate of return is to be read as also referring to—
- (a) a review of the position that no rate of return is prescribed;
  - (b) a review of the position that no rate of return is prescribed for a particular class of case.”
- (3) Any order made by the Lord Chancellor under section 1(1) of the Damages Act 1996 which relates to England and Wales and is in force immediately before the time when subsection (1) comes into force is to be treated after that time as if made by the Lord Chancellor under section A1(1) of that Act.

## Annex B – Explanatory Notes

### Overview of the Draft Clause

1. The purpose of the draft clause (“clause 1”) is to make changes to the way in which the personal injury discount rate applied to lump sum awards of damages for future loss is set.
2. Clause 1 makes provision regarding the personal injury discount rate. It introduces a requirement for regular reviews of the rate and specifies whom the Lord Chancellor, who sets the rate, must consult in conducting a review. It also changes, for the purpose of setting the rate, the level of risk that an investor of damages is assumed to be willing to take in investing his or her lump sum award of damages for future financial loss from “very low” to “low”.

### Policy background

3. Personal injury damages are intended to compensate the claimant for all the losses, past and future, caused by the injury (“the 100% rule”). Future financial loss (e.g. loss of income and costs of care) can be paid by a lump sum or a stream of future payments under a Periodical Payments Order (“PPO”). Awards may include both.
4. The calculation of a lump sum includes applying a discount rate which represents the rate of return that claimants are expected to earn when investing it. The discount rate is intended to ensure that the opportunity to invest does not result in claimants receiving either more or less than 100% compensation. At present, following the leading House of Lords case of *Wells v Wells*<sup>3</sup> the rate is calculated on the basis that the claimant is a very risk averse investor. The rate has, in accordance with this principle, been set by reference to yields on Index Linked Gilts (“ILGs”) since 1998.
5. A discount rate could, in theory, be individually set on a case-by-case basis. However, to simplify the administration of justice, the practice has been for the court to refer to a single rate unless persuaded in the proceedings that another rate should apply (since 2001 the court is not thought to have departed from the standard rate). This rate was originally set by the courts. Section 1 of the Damages Act 1996 gives the Lord Chancellor power to set a rate, which the court is to apply unless the court is persuaded another rate is more appropriate for the case before it. The power under section 1 extends to setting different rates for different classes of cases (although only single rates, covering all cases, have been prescribed to date). The power can be exercised from time to time, with no provision for specific intervals between reviews. Before setting the rate, the Lord Chancellor must consult the Government Actuary and HM Treasury. Section 1 does not specify the methodology to be applied in the setting of the rate – this is largely governed by principles set down in case law by the courts (in particular, the decision of the House of Lords in *Wells v Wells*). Even small changes in the rate can make a significant difference to the size of an individual award.

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<sup>3</sup> [1999] 1 AC 345

6. The Lord Chancellor is under a continuing legal duty to ensure that the rate prescribed is not inappropriate by reference to the requirements of the law. The rate prescribed by the Lord Chancellor applies only to England and Wales (separate provision being made in section 1 for specifying the rate in relation to Scotland and Northern Ireland).
7. The Lord Chancellor's power has only been exercised twice. The rate was set at 2.5% in June 2001 and at minus 0.75% in March 2017. Both rates are "real", that is to say representing a return over inflation as measured by the Retail Price Index.
8. In announcing the setting of the rate at minus 0.75% on 27 February 2017 the then Lord Chancellor said: *"There will clearly be significant implications across the public and private sector. The Government has committed to ensuring that the NHS Litigation Authority has appropriate funding to cover changes to hospitals' clinical negligence costs. The Department of Health will also work closely with General Practitioners (GPs) and Medical Defence Organisations to ensure that appropriate funding is available to meet additional costs to GPs, recognising the crucial role they play in the delivery of NHS care."* She added that *"The Government will review the framework under which I have set the rate today to ensure that it remains fit for purpose in the future. I will bring forward a consultation before Easter that will consider options for reform including: whether the rate should in future be set by an independent body; whether more frequent reviews would improve predictability and certainty for all parties; and whether the methodology – which in effect assumes that claimants would invest only in index-linked gilts – is appropriate for the future. Following the consultation, which will consider whether there is a better or fairer framework for claimants and defendants, the Government will bring forward any necessary legislation at an early stage."*
9. Following this commitment, a consultation paper, "The personal injury discount rate: how it should be set in future", was published on 30 March 2017.<sup>4</sup> This considered options on how, when and by whom the discount rate should be set. The consultation closed on 11 May 2017. A summary of the responses to the consultation has been published. In the light of the responses, and the further research undertaken, the Government has decided it is right that the present law on the setting of the discount rate should be changed.
10. The principal proposals to be given effect by clause 1 are that:
  - a. The rate is to be set by reference to "low risk" rather than "very low risk" investments as at present. This will have the effect of increasing the expected rate of return compared to what it would have been under the present law. Lump sum payments of damages for future loss can thus be expected to be lower than they would have been had the law remained unchanged.
  - b. The rate is initially to be reviewed promptly after the legislation comes into force and, thereafter, at least every three years, with that period being re-set when a review is concluded. Reviews will be completed within 180 days of commencing.
  - c. The rate is to be set by the Lord Chancellor who will consult an independent expert panel (other than on the initial review which will be by the Lord Chancellor who will

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<sup>4</sup> <https://www.gov.uk/government/consultations/personal-injury-discount-rate-how-it-should-be-set-in-future>

consult the Government Actuary). HM Treasury will, as at present, also be a statutory consultee.

It should continue to be possible to set different rates for different types of cases, including by reference to the length of the award.

### **Territorial extent and application**

11. Clause 1 extends and applies to England and Wales only, however, it does not include consequential amendments that would need to be made to other legislation if it were to be enacted. Consequential provision would be necessary because clause 1(2) inserts a new schedule ("Schedule A1") before the existing (and only) schedule to the Damages Act 1996. As a result, the wording of the Damages Act 1996 would have to be altered to rename the existing schedule (currently, the Schedule) as "Schedule 1" and amend other references to the existing schedule so they refer to Schedule 1. This renaming would also extend to Scotland and Northern Ireland because the Damages Act 1996 has provisions that extend also to those countries. No Legislative Consent Motions are expected to be necessary.

### **Commentary on provisions of the draft clause**

12. These provisions in clause 1 make changes to the law of England and Wales.

#### **Clause 1: Assumed rate of return on investment of damages.**

13. This clause inserts a new section A1 in the Damages Act 1996. It also inserts a new schedule A1 into the Damages Act 1996 (before the existing Schedule to that Act, which is in consequence re-numbered as Schedule 1), providing the detail about how the Lord Chancellor is to approach the review and setting of the discount rate. The new schedule makes changes to the methodology according to which the discount rate is set; provides for an initial review of the rate to take place within 180 days of clause 1 coming into force and, thereafter, for reviews to take place at least once every three years; and makes provision for the establishment of an independent expert panel that the Lord Chancellor must consult in setting the rate (other than on the initial review).
14. Subsection (1) inserts the new section A1. The new section sets out the power of the Lord Chancellor to set the rate. It is for the Lord Chancellor to decide whether to set a rate and different rates can be set for different classes of case. If the Lord Chancellor sets a rate the court must have regard to the rate in deciding the return a claimant is expected to receive from investing damages for future financial loss (the court must consider this as part of calculating the size of an award of such damages to be paid by way of a lump sum). In fulfilling its obligations, the court must comply with the rules of court made for the purposes of section A1. No such rules of court have been made to date and none are presently proposed to be made for the new section A1. Subsections (1) to (3) of the new section A1 are in identical terms to the corresponding provision in section 1. Subsection (4) of the new section A1 is new, and provides for the new Schedule A1 (see clause 1(2) below) to have effect. Subsection (5) of the new section A1 specifies how the statutory instrument setting the discount rate is to be made, and is drafted in the same terms as the equivalent provision in section 1(4) of the Damages Act 1996. In summary, the only substantive differences between section 1(1)-(4) of the Damages Act 1996 and the new section A1(1)-(5) are the introduction of the new Schedule and the omission of the requirement to consult the Government

Actuary and HM Treasury before setting the rate (the new consultation requirements being set out in the new Schedule A1).

15. Clause 1(2) contains the new Schedule A1 which is inserted into the Damages Act 1996.
16. Matters dealt with in the new Schedule A1 are as follows: paragraphs 1 to 3 introduce a requirement for the Lord Chancellor to start a review of the rate within 90 days of the date on which the draft clause is brought into force and thereafter to start a review at least once every three years from the conclusion of the previous review. The objective of every review is to decide whether the rate should be retained or changed (see paragraph 8(2)-(4) as to the interpretation of this requirement where there is or will be no rate).
17. In conducting the initial review that is to be commenced within 90 days of the provisions coming into force, the Lord Chancellor is required to consult the Government Actuary. In determining the rate of return, in subsequent reviews, the Lord Chancellor is required to consult an expert panel, which will be chaired by the Government Actuary. Both the Government Actuary, and the panel, must respond within 90 days of the commencement of the relevant review (as determined by the Lord Chancellor). In relation to all reviews the Lord Chancellor must also consult HM Treasury. If the office of Government Actuary is vacant, the Deputy Government Actuary is to act instead.
18. The reviews must be completed within 180 days of their commencement (the date of commencement will be decided by the Lord Chancellor).
19. Paragraph 4 contains provisions relating to the core principles and assumptions to be applied by the Lord Chancellor in determining the rate. Paragraph 4(2) provides that the rate to be set is the rate of return that in the Lord Chancellor's opinion could reasonably be expected to be achieved by a claimant investing a lump sum of relevant damages (defined in paragraph 4(8)) with the objective of covering all the expected costs and losses caused by the injury on time; and, with the further objective that when this has been achieved there is no money left from the lump sum and the income it generated during the period of the award. In forming this opinion, the Lord Chancellor is required to make certain assumptions (and may make others) and to take certain factors into account (which does not rule out taking other factors into account). The specified assumptions are set out in paragraph 4(3). They include that the recipient of the relevant damages receives proper investment advice; and invests in a diversified portfolio of investments; and has a low-risk investment profile. This means the recipient is to be assumed to be willing to take more than a very low risk with his or her investments but less risk than would ordinarily be taken by a prudent and properly advised individual investor with different investment aims. The intention is that the level of risk assumed in the setting of the discount rate will therefore be higher than is assumed under the present law. The specified factors are set out in paragraph 4(5). This requires the Lord Chancellor to have regard to the actual returns available from such diversified portfolios and the actual investments made by investors of relevant damages; and to make appropriate allowances for taxation, inflation and investment management costs.
20. Paragraphs 5 and 6 contain provisions relating to the establishment of an independent expert panel which the Lord Chancellor is to consult in setting the rate. The paragraphs provide for the panel to be chaired by the Government Actuary, and to

contain four other members, namely members with experience respectively as an actuary, as an economist, in managing investments, and in relation to consumer financial investments. The panel is to be appointed for each review; but serving on the panel in relation to one review will not disqualify an appointee from serving on the panel for another review. The panel dissolves when the Lord Chancellor's consultation with it is complete. The cost of the panel will be met by the Lord Chancellor, who may enter into arrangements with other government departments so that they can assist, such as by providing a secretariat to the panel. Meetings of the panel will not be quorate unless the Government Actuary or the Deputy Government Actuary is present. As there may be more than one review ongoing at any time (see paragraph 7) provision is made for individuals to be members of more than one panel.

21. Paragraph 7 contains provisions as to how the Schedule should apply if two or more discount rates are prescribed as a result of a review. Different rates might, for example, be prescribed for different durations of loss. The requirements as to when and how a review is conducted will apply separately to each. This enables the Lord Chancellor to carry out reviews of different rates separately at different times, but different rates may also be reviewed at the same time (in the latter case one or more members of the panel for the review of one rate might also be members of the panel for another rate).
22. Clause 1(3) provides that the rate in force under the present law when clause 1 comes into force (currently, minus 0.75%) will continue in force as if the order setting the rate had been made under the new provisions. This rate will therefore be reviewed in the initial review (see the new Schedule A1, paragraph 2).

### **Commencement**

23. The mechanism by which clause 1 will be brought into force will be specified in the Bill of which the clause ultimately forms part. It is expected that the Bill will provide that clause 1 will come into force on such day as the Secretary of State may by regulations appoint.

### **Financial implications of the draft clause**

24. The new process for prescribing an assumed rate of return will entail consulting an expert panel at intervals of up to three years. The extra expenditure incurred when there is a review and consultation with an expert panel is estimated to be between £50,000 and £100,000.

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