

Title: The Personal Injury Discount Rate. How it should be set in future IA No: MoJ011/2017 RPC Reference No: N/A Lead department or agency: Ministry of Justice (MoJ) Other departments or agencies:	Impact Assessment (IA)			
	Date: 29 March 2017			
	Stage: Consultation			
	Source of intervention: Domestic			
	Type of measure: Primary legislation			
Contact for enquiries: Paul Hughes Tel: 020 3334 3198				

Summary: Intervention and Options	RPC Opinion: N/A
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Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014 prices)	One-In, Three-Out	Business Impact Target Status
£0m	£0m	£0m	Not in scope	Not in scope

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

Where damages for personal injury are awarded for future loss in the form of a lump sum, that award is adjusted to reflect the fact that the injured person is able to invest the money before the loss or expense for which it is awarded has actually occurred. The factor by which the award is adjusted is determined by the personal injury discount rate (PIDR) which represents the appropriate rate of return on investing the award. In England and Wales the PIDR is set by the Lord Chancellor under s1 of the Damages Act 1996. A PIDR of minus 0.75% has been effective from 20th March 2017, set by reference to a three-year average of real gross redemption yields on index linked gilts (ILGS). There are, however, concerns that reference to such low risk investments may over-compensate some claimants (or, equivalently, lead to higher costs to defendants). There are also concerns that some parties may receive unfair outcomes if the rate is not set frequently enough to reflect prevailing economic conditions or that decisions concerning the rate are not informed by a suitable range of expertise in an open and transparent way. Government intervention is required to change the legal parameters used to set the PIDR.

What are the policy objectives and the intended effects?

The policy objective is to revise the principles for setting the discount rate to produce an award that is fair between claimant and defendant in providing 100% compensation, neither more nor less, for the wrongful injury. In doing this, the consultation considers possibilities for how, when and by whom the discount rate in relation to personal injury claims in England and Wales should be set.

What policy options have been considered, including any alternatives to regulation?

Option 0: Do nothing. Continue to set the rate under section 1 of the Damages Act 1996 in accordance with the current legal framework.

Option 1: Change the legal framework under which the discount rate is set, in particular changing assumptions about the level of risk of the investment portfolio against which the rate should be set.

Option 2: Specify how frequently or under what considerations the discount rate should be reviewed.

Option 3: Set up an expert panel appointed to set or advise on what the personal injury discount rate should be.

Options 1, 2 and 3 could be combined. At this stage the Ministry of Justice does not have a preferred option.

Will the policy be reviewed? It will be reviewed. **Review date:** 3 to 5 years after royal assent

Does implementation go beyond minimum EU requirements?	N/A			
Are any of these organisations in scope?	Micro Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: N/A		Non-traded: N/A	

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:** 30 March 2017

Summary: Analysis & Evidence

Policy Option 1

Description: Change the legal framework under which the discount rate is set, in particular changing assumptions about the level of risk of the investment portfolio against which the rate should be set

FULL ECONOMIC ASSESSMENT

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'

None monetised. A quantitative assessment would require specific data on the risk profile of personal injury claimants which is unobservable. The MoJ is seeking information on actual investment decisions made by claimants to understand this and improve the evidence base via the consultation to which this IA relates.

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

A change to a higher level of risk would most often lead to a higher discount rate because of the associated higher rates of return realised from such investments. This would result in smaller lump sum compensation payments which would be a cost to claimants, addressing any over-compensation they may currently be enjoying. Some claimants with a low appetite for risk may also face increased costs associated with volatility of investments or lower returns depending on their investment behaviour.

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'

None monetised. A quantitative assessment would require specific data on the risk profile of personal injury claimants which is unobservable. The MoJ is seeking information on actual investment decisions made by claimants to understand this and improve the evidence base via the consultation to which this IA relates.

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

Defendants would benefit from smaller lump sum payments. This would include public sector bodies (for example the NHS) and insurers. There may be benefits to wider society in terms of lower insurance premiums, if insurance companies are paying out less, and generally in terms of equity if this option reduces the level of over-compensation. We have not monetised these benefits at this stage.

Key assumptions/sensitivities/risks

It is assumed that claimants vary in their risk appetite, capacity for loss and investment behaviour. We assume no change in the volume of personal injury cases following a change in the discount rate. It is assumed that there is no change in the costs of reaching a settlement. There is a risk that some claimants may exhaust their awards earlier than expected if the discount rate is set with respect to a higher risk tolerance. However, these impacts could be mitigated by having more than one rate for different types of claimant, duration of award or heads of claim. Also, periodical payment orders (PPOs) already exist for appropriate cases. It is assumed that insurance companies pass on any savings derived from a higher discount rate onto consumers in the form of lower insurance premiums.

Discount rate

NA

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: NQ	Benefits: NQ	Net: NQ	
			NA

Summary: Analysis & Evidence

Policy Option 2

Description: Specify how frequently or under what considerations the discount rate should be reviewed.

FULL ECONOMIC ASSESSMENT

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' None quantified. We will be seeking views on potential impacts of this option in the consultation.						
Other key non-monetised costs by 'main affected groups' Administrative costs will depend on the frequency of review (which may also depend on whether any triggers are set defining when a review is required). If triggers are set (e.g. a specified percentage point change in the return of an appropriate index), there needs to be a mechanism in place to monitor the index. Any such administrative costs are expected to be negligible. Depending on the frequency and direction of any discount rate change, reviews will lead to costs either to claimants or defendants, when compared with keeping an existing rate in force.						
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' None quantified. We will be seeking views on potential impacts of this option in the consultation.						
Other key non-monetised benefits by 'main affected groups' Depending on the frequency and direction of any discount rate change, reviews will lead to benefits either to claimants or defendants, when compared with keeping an existing rate in force. We will be seeking views on potential impacts of this option in the consultation.						
Key assumptions/sensitivities/risks					Discount rate	NA
The analysis performed in this IA is based on hypothetical illustrative real yields on ILGS assuming three broad trends (flat, upward, downward). This is intended to inform the types of considerations to be taken into account when determining a suitable approach for defining the frequency of review for the discount rate. It is noted that in practice, any suitable reference portfolio could be chosen.						

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: NQ	Benefits: NQ	Net: NQ	
			NA

Summary: Analysis & Evidence

Policy Option 3

Description: Set up an expert panel appointed to set or advise on what the personal injury discount rate should be.

FULL ECONOMIC ASSESSMENT

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'

None quantified. We will be seeking views on potential impacts of this option in the consultation.

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

There would be administrative costs in relation to setting up and maintaining an expert panel. Such costs are assumed to be negligible. Claimants and defendants would not be affected by the institution of a panel.

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'

None quantified. We will be seeking views on potential impacts of this option in the consultation.

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

Claimants and defendants would not be affected by the institution of a panel.

Key assumptions/sensitivities/risks

It is assumed that the volume of personal injury claims subject to the discount rate will not change as a result of the institution of a panel.

Discount rate

NA

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: NQ	Benefits: NQ	Net: NQ	
			NA

Evidence Base (for summary sheets)

A. Background

The Personal Injury Discount Rate

1. Under the current legal framework, the Personal Injury Discount Rate (PIDR) is set by the Lord Chancellor under section 1 of the Damages Act 1996. The precise principles applied are those established in case law, in particular the case of *Wells v Wells* [1999] 1 AC 34.
2. The current legal framework makes clear that claimants must be treated as very risk averse investors, reflecting the fact that they may be financially dependent on the lump sum awarded, often for long periods or the durations of their lives. The principles in *Wells v Wells* lead to the conclusion that the PIDR should be based on the investment portfolio that offers the least risk to personal injury claimant investors in protecting an award of damages against inflation and against market risk. A portfolio that contains 100% Index-Linked Gilts (ILGS) best meets that criterion.
3. The object of the award of damages set out by the House of Lords in *Wells v Wells*, by Lord Hope of Craighead (page 390A-B) is as follows:

“...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...”

4. Under these principles, the PIDR should be such that a claimant is not better or worse off, but fully compensated for their losses. This is the principle of ‘100 per cent’ or ‘full’ compensation.
5. The PIDR performs a central role in ensuring this objective. Where damages are awarded for future loss in the form of a lump sum, that award is adjusted to take account of the effect of the injured person being able to invest the money before the loss or expense for which it is awarded has actually occurred. The award is adjusted by a factor which is based on the PIDR. The PIDR represents the appropriate rate of return on investing the award. It is applied once the court has assessed the claimant’s financial losses associated with the injury – principally those relating to reductions in future income and any on-going medical and care expenses.
6. The forms of personal injury where the PIDR is most commonly (though not always) applied occur as a result of medical negligence, industrial accidents and road traffic accidents. As these are often instances where the liable defendant will hold insurance, any lump sum will ultimately be met by an insurer but may be recouped from insurance premiums payable by all policy holders or by other means, such as a bond issue. In many cases of clinical negligence, costs will also fall on the National Health Service (NHS) (and similar services in the devolved administrations), medical defence organisations and, ultimately, the taxpayer. A higher PIDR implies lower costs to insurance policy holders and to the taxpayer because lump sum awards are discounted more under a higher PIDR (i.e. awards are smaller for any given heads of claim). It should be noted, however, that the Lord Chancellor cannot consider costs to defendants when setting the PIDR under the current legal framework.

Issues with the Current Legal Framework

7. While the PIDR is currently set with reference to the return on ILGS, this return does not determine what claimants may actually invest in. This gives rise to concerns that the assumption that all claimants should be treated as very risk averse investors, or have a very low capacity to absorb a loss, may not always be appropriate as some claimants may be able, and willing, to invest in assets which are riskier than ILGS and which, therefore, may achieve a higher return. If this is so, the

principles established in *Wells v Wells* would lead to the award of a lump sum which would over-compensate such claimants.

8. In addition, in certain situations, the claimant may be offered a periodical payment order (PPO) instead of a lump sum. PPOs are orders of the court made under section 2 of the Damages Act 1996 that specify that payments are to be made by the defendant to the claimant at fixed intervals over a period of time¹. A PPO involves the regular payment of the assessed costs of the injury for the remainder of the claimant's life or the expected duration of the injury (as appropriate). Where PPOs are available, for example from an insurance company or from the NHS Litigation Authority (NHSLA), the body paying the PPO assumes the investment risk rather than the claimant. In the cases, therefore, that claimants choose lump sums over PPOs, one could argue that there exists some class of claimants who have a higher risk tolerance than is implied by investment in risk-free ILGS
9. In addition to the risk of over-compensation, there is currently no set frequency for how often the PIDR should be reviewed, aside from the power the Lord Chancellor has to conduct a review from time to time. This creates uncertainty and means that the PIDR may, over time, depart from that which would be implied by the average real yields on ILGS. Establishing rules in relation to the review frequency could provide clarity and increase certainty.
10. It may also be advantageous in terms of openness, transparency and accuracy for the rate to be set on the basis of a wider range of expert advice than currently taken.
11. Given these concerns, the Government has decided to consult on the legal framework within which the PIDR is set. This Impact Assessment (IA) accompanies the consultation document.

B. Rationale and Policy Objectives

12. 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 redistributive reasons (e.g. reallocating resources from one group in society to another).
13. In this case intervention is primarily justified on equity (fairness) grounds: to ensure that successful claimants are neither under nor overcompensated for their losses. While the current methodology for setting the PIDR may produce over-compensation for some claimants, which would impose unnecessary costs on society generally, a PIDR which is too high may lead other claimants to take excessive investment risks and, in some cases, to exhaust their award earlier than expected. In such cases, the taxpayer would become responsible for meeting their remaining care and income needs.
14. The policy objectives are to increase the level of transparency, certainty and accuracy in setting the PIDR in future. Greater transparency and certainty could benefit all the parties involved while a PIDR which better reflects the current or most recent returns on the appropriate investment assets would ensure lump sum payments for injuries of a similar nature do not vary substantially simply because the PIDR becomes out of date if not set according to current economic conditions.

C. Affected Stakeholder Groups, Organisations and Sectors

¹ The most common form of periodical payment orders are orders where the payments can simply be index-linked to a variety of indices, including, for example, the Retail Price Index and Annual Survey of Hours and Earnings (ASHE) 6115. The Annual Survey of Hours and Earnings provides data on levels, distribution and make-up of earnings and hours worked for UK employees by sex and full-time or part-time status in all industries and occupations. The Standard Occupational Classification code for care assistants and home carers is 6115.

15. The following individuals/sectors are likely to be affected by the proposals:

- Claimants in personal injury cases and, in some cases, their personal representatives.
- Defendants in personal injury cases, including public sector bodies, such as the NHS, other businesses, and insurers.
- Members of an expert panel if appointed under Option 3 and any third parties commissioned to inform the decision on what the PIDR should be.
- Legal services providers, financial advisers, wealth managers and professional deputies.
- Her Majesty's Courts and Tribunals Service (HMCTS) and the judiciary.
- Government administrations, including the Ministry of Justice.
- Wider society, either as taxpayers or as those with views concerning equity and fairness, and as individuals (both in their roles as those currently paying insurance premiums and taxation but also as potential claimants in future personal injury cases).

16. Of these, only claimants and defendants are examined in detail in the cost and benefit analysis that follows (Section E). Others are only affected marginally or indirectly. In the rest of this section we briefly explain the possible impacts on those parties who are less likely to be affected by each of the options.

17. Legal service providers would not be affected by any of the options proposed. Firstly, in personal injury cases, the lawyer's fee is not directly related to the damages recovered and the success fee under any conditional fee arrangement or damage based agreement agreed with the claimant is capped at a level determined by reference to damages for pain, suffering and loss of amenity and past loss (to which the PIDR does not apply) rather than damages for future pecuniary loss (to which the PIDR applies). Secondly, there is unlikely to be any latent demand for legal services among victims of serious personal injury. We assume that the volume of cases handled by lawyers will not change under any of the options considered.

18. There is scope for an extended negotiation process if the frequency of review is not set appropriately under Option 2. For example, where the PIDR is set regularly but infrequently and is no longer appropriate under current economic conditions, affected parties may attempt to delay settlement until there is a new rate which is more favourable to themselves. However, any additional fees a lawyer may claim for the work conducted during an extended negotiation may be offset by the opportunity cost of not taking up other cases.

19. Professional financial advisors and wealth managers (including the investment arms of insurance and legal service firms), who advise claimants how to invest lump sums or manage the claimant's assets will often charge a fee related to the amount invested. Any change to the PIDR resulting from a change in the assumed risk tolerance of the claimant is likely to have a financial impact on this group (unless the lump sum awarded is sufficiently large that they consider the claimant could achieve the required return without the need for active portfolio management or advice). Professional deputies appointed to manage the affairs of claimants lacking mental capacity would be similarly affected. We do not consider these any further because the impacts are qualitatively similar to those on the claimant and quantitative impacts are not considered generally at this stage.

20. Professional financial advisors and wealth managers are regulated by the Financial Conduct Authority and are required to consider their clients' best interests when providing their services. We have not, therefore, considered as likely any perverse incentives among these professionals to advise investing inappropriately (for example advising investment in high yield, high risk assets for the sake of raising fee income) under any given set of principles developed under Option 1.

21. The courts are unlikely to be affected by any of the options presented here over and above being the decision makers to whom the rate is directed. There may be small additional costs related to training and guidance to judges in applying any new rate, especially if the rate is set more regularly. We assume no change in claim volume and no change in the volume that reach later court stages. To

the extent that the latter does change, the additional volume is expected to be negligible in comparison with the court's existing workload.

22. Government administrations such as the Ministry of Justice may be engaged in the decision-making process to a greater or lesser extent than currently. The change is assumed to be handled as business-as-usual work with negligible financial impact. There would be remuneration or at least disbursement costs associated with administering an expert panel considered under Option 3.

D. Description of options considered

23. To meet the policy objectives, the consultation proposes a range of options for reforming the legal framework used for setting the PIDR in future. These options are not mutually exclusive and could be implemented either on their own or in combination with one or more of the others. However, for simplicity we examine the impacts of each separately. These options are:

- **Option 0: Do Nothing/Base Case. Continue to set the rate according to the procedures described in the Damages Act 1996.**
- **Option 1: Change the legal framework under which the discount rate is set, in particular changing assumptions about the level of risk of the investment portfolio against which the rate should be set.**
- **Option 2: Specify how frequently or under what considerations the discount rate should be reviewed.**
- **Option 3: Set up an expert panel appointed to set or advise on what the personal injury discount rate should be.**

24. The Government does not have a preferred option at this stage.

Option 0: Base Case

25. Under the 'do nothing' option the principles underpinning the setting of the PIDR would not change: A single PIDR would continue to be set by the Lord Chancellor under the current legal framework, including the principles from *Wells v Wells*.

26. Under Option 0, while very risk averse claimants (those with a very low risk appetite or capacity to suffer a financial loss) would receive appropriate compensation, this would not be true for any claimants who have a greater capacity to suffer a loss, and who may invest in a wider range of assets. Such individuals (insofar as they exist) may obtain a higher return, on average, on any investment of their lump sum than is possible from ILGS alone and would, therefore, be overcompensated.

27. Under Option 0, the Lord Chancellor would continue to be responsible for setting the PIDR after seeking the views of statutory consultees, HM Treasury and the Government Actuary, without a specified time period for a review.

Option 1: Change the legal framework under which the discount rate is set, in particular changing assumptions about the level of risk of the investment portfolio against which the rate should be set

28. Under this option, the hypothetical claimant, to which the Lord Chancellor (or other decision-maker) refers when setting the PIDR, would not necessarily be assumed to be a very risk averse individual or one with a very low capacity for loss. Instead the individual, or some class of individuals, would be assumed to be able to bear more financial risk than assumed by the principles from *Wells v Wells*.

29. Were some claimants deemed to have a higher capacity for loss, this would justify the decision-maker considering, for example, a mixed portfolio of assets as the benchmark investment for setting the PIDR. Mixed portfolios, containing a range of assets besides ILGS, generally carry higher

investment risks than ILGS alone but also, on average, a higher rate of return. Consequently, a shift in the assumed risk tolerance of the claimant would support a higher PIDR.

30. Alternatively, the decision-maker could set a PIDR based upon the risk free return indicated by the average real yield on ILGS plus a risk margin chosen to reflect the assumed additional risk tolerance of the claimant. In either case, lump sum payments would likely be lower than under the current legal framework, meaning claimants as a whole would be paid less by defendants.
31. Any increase in the assumed risk tolerance of the claimant would mean that every claimant would run a higher risk of exhausting their award earlier than expected. For some, who already invest in mixed portfolios, this is a risk they already bear to some extent. The shift would additionally mean they are no longer over-compensated *on average*, or at least would be less over-compensated than they are now: the PIDR would more closely match the expected return on investment they currently achieve. Others, who have lower risk appetite, would have to adjust their investment strategies to achieve the return implied by a higher PIDR. A subset may be unwilling to take on the extra risk and would be under-compensated.
32. Under the existing legal framework, the Lord Chancellor may set more than one PIDR. Therefore under this option, one strategy for reducing the risk of under-compensating claimants with the lowest risk tolerance would be to introduce different PIDRs for different types of loss. Thus the PIDR might differ by the 'head of claim' (i.e., be lower for the costs associated with treatment and on-going care than those for lost earnings) or the expected duration or size of the award. A different PIDR might also be applied where a PPO has been offered but has been declined by the claimant.

Option 2: Specify how frequently or under what considerations the discount rate should be reviewed

33. Under this option, the person or body with responsibility for setting the rate would be charged with reviewing the rate after a set period of time – for example, every three years – and/or when triggered by a threshold change in the returns on the investments by reference to which the rate is set.

Option 3: Set up an expert panel appointed to set or advise on what the personal injury discount rate should be

34. Under Option 3, responsibility for setting the PIDR or advising on what it should be would be transferred by statute from the Lord Chancellor to an expert panel. The panel would be made up of appropriate experts: for example, actuaries, financial experts, investment advisers, and economists, selected or nominated for the purpose. The appointments would need to comply with the Commissioner for Public Appointments Code.

E. Cost and Benefit Analysis

35. This IA identifies *non-monetised* impacts of the proposed policy on individuals and groups in the UK. Impacts are not monetised primarily due to the way the consultation is set out, whereby views on policy options are being sought with an open mind. Thus, we consider it important to outline the principles under which the PIDR should be set and for stakeholders to understand these, rather than focussing on definitive impacts at different levels the PIDR could be set. Furthermore, in this instance, existing quantitative evidence on the risk profile of personal injury claimants is scarce and we will look to improve the evidence base through the consultation.
36. The costs and benefits of each policy option are compared with the “do nothing” option. As the ‘do nothing’ option is compared against itself, the costs and benefits of this option are necessarily zero.
37. It is normal practice in IAs to ignore effects which only represent the redistribution of resources between individuals (‘transfer payments’) and to include in the impacts section only those which relate to the use of real resources. However, in the case of reforms to the PIDR, and especially any effects of changing the methodology by how it is set, reform would lead to material changes in the distribution of resources between claimants, defendants and wider society. Given the nature of the

groups affected and the magnitude of any potential changes, we think it is important to include these effects within the IA so as to inform properly the consultation process.

Option 1: Change the legal framework under which the discount rate is set, in particular changing assumptions about the level of risk of the investment portfolio against which the rate should be set

38. Option 1 would lead to a change in the legal framework whereby amongst other things claimants are assumed to be able to bear more investment risk, resulting in a PIDR higher than under the current approach. A higher PIDR would lead to lower lump sum compensation payments as future losses would be more heavily discounted. This would primarily represent a transfer from claimants to defendants including the NHSLA and insurers. Most of these savings are assumed to be transferred to wider society in the form of lower government spending and lower insurance premiums.

Investment risk, risk factors for claimants, and assumed investment portfolios

39. Option 1 departs from the assumption under the current legal framework that the claimant is a very-low risk investor. While the principle of full compensation would be retained, namely that the claimant's award should place him or her in the same financial position as if the injury had not occurred, the claimant would be assumed to be able to bear some investment risk.

40. Investment risk is exposure to scenarios where the value of an investment can go up or down. As a general rule, a high rate of return on an investment is associated with high risk. This is because, if someone invests in a risky portfolio whereby the value of the investment can go up or down, he or she needs to be compensated for taking on this "risk" by receiving a greater return on his or her investment (over the alternative of investing in a risk free asset with guaranteed returns). A summary of some of the risks a claimant may need to consider can be viewed at Annex A.

41. The degree to which a claimant will assume risk in pursuit of a given rate of return, i.e., the claimant's risk tolerance, may be divided into two components:

- Risk appetite: this relates to the risks the claimant is willing to take. These relate to the claimant's personal circumstances but also the claimant's personal preferences for risk. For example, two claimants who may have similar personal characteristics and circumstances could have different preferences for risk. One claimant may only be willing to invest in ILGS, whereas the other may be willing to invest in riskier assets.
- Capacity for loss: this refers to the risks the claimant is able to take. These are often determined by a claimant's personal characteristics and circumstances, which would include age, life expectancy, the severity of their injury and the level of ongoing care required. For example, a claimant may not be in a position to take any risk because he or she has particular and expensive care needs and no access to alternative funds.

42. A claimant's natural risk appetite is unobservable. As a proxy, claimant's investment behaviour may be used to gauge their preferences for risk. We are gathering evidence of how claimants actually invest awards of damages for future financial loss alongside the consultation. However, it is not possible to draw firm conclusions from a claimant's investment strategy to form a view of their intrinsic attitude to risk. This is because it is important to understand that the PIDR and a claimant's investment strategy will determine one another, i.e. the size of a claimant's lump sum (determined by the PIDR) will often define the investment strategy pursued.

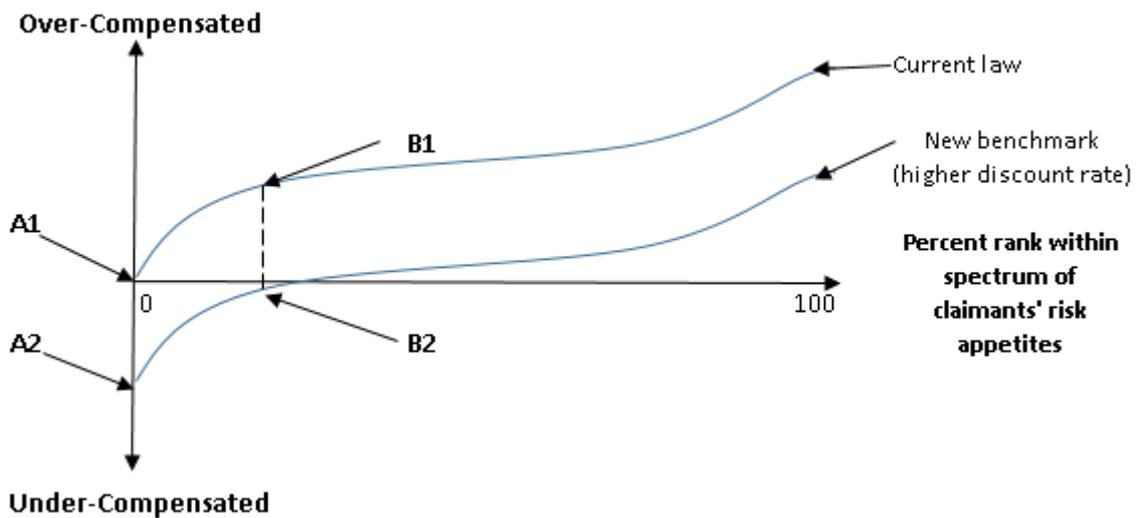
43. Claimants who lack the capacity to manage their own affairs will have investment decisions made for them by a representative who may consider it inappropriate to take any more risk than is absolutely necessary. They are limited by current case law in this respect.

44. Claimants need to follow an investment strategy that provides them with the confidence that their expenses will be met on time. In the event of a higher PIDR, the most risk averse claimants may need to take on more risk than they would have done otherwise, to ensure that compensation lasts for their lifetimes. Claimants, may also need to make provision for the risk that the duration of their

injuries or their life expectancies may exceed that assumed when their lump sums were calculated. This may be a factor in claimants' investment strategies under the current methodology based on ILGS.

45. The current legal framework, including the principles from *Wells v. Wells*, makes clear that claimants must be treated as *very* risk averse investors, reflecting the fact that they may be financially dependent on the lump sum awarded, often for long periods or the duration of their life. The principles in *Wells v Wells* lead to the conclusion that the PIDR should be based on the investment portfolio that offers the least risk to personal injury claimant investors in protecting an award of damages against inflation and against market risk. A portfolio that contains 100% ILGS comprising stocks spread across a range of redemption dates best meets that criterion. Such a portfolio would guarantee the investor an inflation-adjusted income, known with certainty at the time of the award, but would not have a high return. In this instance, the PIDR would be low.
46. By contrast, if it were assumed instead that the claimant can bear some risk, an alternative portfolio may be more appropriate as a basis of setting the PIDR, most likely a mixed portfolio, containing a range of assets besides ILGS. Mixed portfolios generally carry higher investment risks than ILGS alone but also, on average, a higher rate of return. This would commend a higher PIDR. However, the higher risk associated with a mixed portfolio might mean that some claimants would be worse off if they are unwilling or unable to take risk due to their personal preferences and personal care needs.
47. Figure 1 (below) demonstrates this point diagrammatically. The upper curve represents the levels of expected compensation experienced by individuals across the full spectrum of risk appetites, from the most risk averse on the left to the least on the right, under the current principles. Individuals are imagined to invest according to their risk appetites and average real return is assumed to be positively correlated with investment risk.
48. Using ILGS as the benchmark for setting the PIDR, which effectively assumes all claimants adopt a virtually risk-free investment strategy, minimises the risk that claimants will be undercompensated for their future losses by setting the PIDR at the lowest level possible. Label A1 relates to the most risk averse individual, assumed to invest in ILGS. By definition, this individual is neither over-compensated nor under-compensated.
49. Where claimants adopt a different investment strategy with the potential to outperform the risk free rate, they have the potential to place themselves in a better financial position than had the incident not occurred. The label B1 relates to such a claimant (in this case a claimant with a moderately higher risk appetite). On average, claimants at B1 would receive a higher return, although it should be noted that, as they are taking on riskier investments, some, in practice, may suffer losses related to the investment risk they have taken on.

Figure 1: Implication of moving away from assuming all claimants are risk averse as defined in *Wells v Wells*



Notes: Upper curve: The current law prescribes that the PIDR should be set so as to fully compensate the most risk averse individual (A1). Those with the lowest risk appetite (A1) are compensated but those with more freedom to make higher risk investments (e.g. B1) are likely to be over-compensated on average (although they may find that, in practice, the risk they have taken on means they suffer losses associated with higher risk portfolios). Lower curve: if a higher risk appetite were assumed, the PIDR would be elevated and, unless they were prepared to take on more risk, the most risk averse individuals would be undercompensated (A2). Similarly, fewer claimants would be over-compensated (e.g. B2). Curves are illustrative.

50. If, on average, claimants adopt a higher risk profile than ILGS and as a consequence have the potential for higher returns, then in aggregate the current law is at risk of overcompensating claimants. If the benchmark risk appetite by which the PIDR is set were raised, a higher PIDR would result. All claimants of a given risk appetite would receive lower lump sums and the lower curve might be more representative of the balance of over and under compensation. As such, the most risk averse claimant will be expected to be undercompensated, *assuming he or she is not willing to change his or her investment behaviour to achieve a higher expected return*. This claimant has moved from A1 to A2 in the chart.
51. The claimant shown as B1 under the current law would move to position B2 with the new benchmark, and, on average, be slightly undercompensated given his or her position along the risk spectrum.
52. In practice, even the most risk averse claimants may be able to adjust their investment profiles to obtain full compensation, on average, under an elevated PIDR but, where this is not the case, either

because the claimant investor is unwilling or unable to assume more risk, the claimant would be undercompensated.

53. One way to protect claimants with a very low risk tolerance, while reducing the risk of overcompensating others, might be to vary the PIDR in relation to the characteristics of a claimant's award. We outline three scenarios where different PIDRs could be applied. This list is not exhaustive:
- The first is one whereby a separate rate is applied depending on the term of loss. This could mean one rate for claims with terms that fall under a certain number of years and another rate for claims with longer terms.
 - The second is applying a separate rate depending on the size of award. This could be one rate for claims settled under £1m and another rate for claims over £1m, for example.
 - The third is applying a separate rate depending on the type of loss. This could mean a separate PIDR is applied to care costs and another rate for loss of earnings, for example.
54. Another way to compensate claimants with a very low risk tolerance is to encourage the use of PPOs. If the PIDR were higher than what is currently the case, resulting in a lower lump sum being awarded, it could make PPOs more attractive to claimants.
55. PPOs are in principle suitable for high value, personal injury claims which are likely to extend over a long period. They are thought primarily to be used to meet the cost of future care and to be combined with lump sum payments. Therefore, in a scenario where the value of the PIDR may be incompatible with the risks a claimant is able to take, PPOs could be used instead, if available.

Illustrative examples

56. To assess the potential costs and benefits of this option it is necessary to make some assumptions about the preferences and investment behaviour of different claimants, as this will determine the costs and benefits that they face under Option 1. While little information is available on claimants' investment preferences, it would be expected that, in reality, claimants vary in their appetite for investment risks.
57. For the purposes of this IA it is assumed that claimants may be split into two broad groups with reference to the PIDR:
- A) Claimants whose risk appetites are in line with that assumed by the current legal framework. This group of claimants would prefer to invest in assets that have less investment risk and lower average returns than those that would be used to set the PIDR where the assumed PIDR is higher. Following changes in the risk appetite assumed when setting the PIDR, these claimants may behave in the following ways:
- They may invest in assets that are riskier and have higher average returns than their risk appetites imply; or
 - They may invest in assets that are lower risk and have lower average returns than those which the PIDR is based on, as per their risk appetites.
 - They may express a preference for settling their claim by PPO, where relevant and available.
- B) Claimants whose risk appetites are higher than that assumed in the current legal framework. This group of claimants would prefer to invest in the assets which are used to set the PIDR or riskier assets with higher average returns. It is assumed that this group of claimants would invest in assets which align with their risk appetites following changes in the assumed risk when setting the PIDR.

Costs of Option 1

58. Were the legal framework under which the PIDR is set to change, there might be some one-off familiarisation costs for all affected parties. These costs are expected to be negligible. In the

following, it is assumed that a change in the legal framework would lead to an increase in assumed risk tolerance and an increase in the PIDR with respect to Option 0.

Claimants

59. A higher PIDR would result in reduced lump sum compensation to claimants relative to the base case (Option 0). This would be a cost to claimants and a benefit to defendants.
60. A higher PIDR may also lead to costs to some claimants if they invest in assets with more investment risks than they otherwise would have done, to ensure that their lump sum awards meet their requirements. As outlined earlier, some claimants who have risk appetites lower than that implied by the new PIDR may choose to invest in riskier assets than their appetites imply, as a result of a change in the PIDR. Such claimants would be affected by higher costs associated with greater volatility if investment risks materialise. Some of these risks are outlined below.
61. The capital investment could be volatile due to the inclusion of riskier assets such as equities. There could 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. Finally, although equities offer some protection against inflation, they are not index-linked, unlike ILGS.
62. The income generated by assets may not be sufficient to cover claimants' ongoing costs, due to cost inflation outpacing the income yield on assets, leading to a risk that an investor is forced to sell some assets to meet costs as they arise. Furthermore, fluctuations in capital values might lead the claimant to get a low price for the asset and deplete the award of damages more quickly than planned. This may prompt the claimant to increase risk in their investments in order to recoup the losses, which could lead to further losses. There may also be tax implications and transaction costs as a result of being forced to sell investments earlier than expected.
63. These claimants may also face additional costs associated with managing their investments although these may be passed on to defendants as part of the total compensation award.
64. Alternatively, if claimants with lower risk tolerances are unwilling or unable to invest in the types of assets used to set the PIDR they may invest in less risky assets with lower average rates of return. In this case they would not fully achieve the streams of income assumed in their settlements and would risk running out of money before the expected terms of their awards. In the event a claimant actually runs out of money, he or she would be reliant on the NHS and state benefits, with associated costs to the taxpayer.
65. If there were measures in place to mitigate the impacts on this group of claimants in the form of a PIDR varying by the term of loss, size of award, heads of claim or varying by some other factor, the impact on this group would be reduced. However, introducing varied rates according to a certain factor may create perverse incentives for claimants. For example, it could encourage claimants to change their claim according to that factor so that their claim would fall under the most favourable PIDR.
66. Claimants who have a risk appetite equal to or greater than that implied by the PIDR are assumed to continue to invest in assets which are consistent with their risk appetite and are assumed to be unaffected by additional costs from investment risk or management. That said, if a higher PIDR were

used to calculate the compensation lump sum owed, this would result in a lower award, which may in turn affect their investment choices.

Defendants

67. Any change in the costs to claimants of managing lump sums might ultimately be passed to defendants as part of negotiating the final settlement.
68. A higher PIDR may make PPOs relatively more attractive to claimants who are unwilling or unable to invest in higher risk portfolios. PPOs are expensive for insurers who must hold capital to meet solvency requirements under Solvency II. An increased propensity for PPOs would, therefore, represent an immediate cost to insurers, albeit one that is offset by the reduced or absent lump sum in cases settling by a PPO rather than a lump sum alone. The NHSLA pays for its liabilities on a 'pay-as-you go' basis and is not required to hold assets to cover PPOs so would not be affected in the same way as insurers.

Society and wider economy

69. Society may suffer a cost if a move to a higher assumed risk tolerance led to those in greatest need facing a higher level of risk of not having enough money. There are potential issues related to the principle that claimants should be expected to take on risk and may, in some instances, suffer the stress of running out of money and becoming dependent on the state.

Benefits of Option 1

Claimants

70. A higher PIDR may make PPOs more attractive to claimants who are unwilling or unable to invest in higher risk portfolios.

Defendants

71. A higher PIDR is expected to result in reduced lump sum compensation awards by defendants relative to the base case. Defendants would include insurers, government bodies such as the NHS and uninsured businesses and individuals. In the case of insurers this could be expected to lead to benefits being passed on to consumers in the form of lower insurance premiums relative to the base case.
72. The NHSLA would benefit in the short term from an increased PPO propensity as it would mean lower immediate payments in the cases settling with a PPO rather than a lump sum alone, although total future liabilities would increase.

Society and wider economy

73. Society may benefit from greater equity (fairness) if the current legal basis is perceived to over-compensate personal injury claimants.
74. Individuals and businesses in wider society may also benefit from lower insurance premiums if insurers face lower costs. Such businesses and individuals would also be potential defendants. This would be an indirect impact of this proposal. If insurance premiums drop as a result of assuming a higher risk tolerance, this may lead to more people being able to take out insurance. Wider society would benefit in the form of lower government spending on compensation payments.

Option 2: Specify how frequently or under what considerations the discount rate should be reviewed

75. The PIDR should reflect the returns on the investments by reference to which the rate is to be set. In principle, subject to avoiding over-frequent changes, it should, therefore, be reviewed as often as is

necessary to reflect material changes in returns from those investments. The rate is an approximation of the underlying investment return and will result in claimants and defendants being either advantaged or disadvantaged depending on whether, at the point of settlement, the PIDR is either higher or lower than the rate implied by the underlying investment.

76. For simplicity, this section discusses the implications of reviewing the PIDR at different time intervals, e.g. 1, 2, 3, 5 or 10 years. Hypothetical scenarios of future real yields on ILGS are considered below, allowing us to illustrate the impacts on claimants and defendants of fixed review intervals.

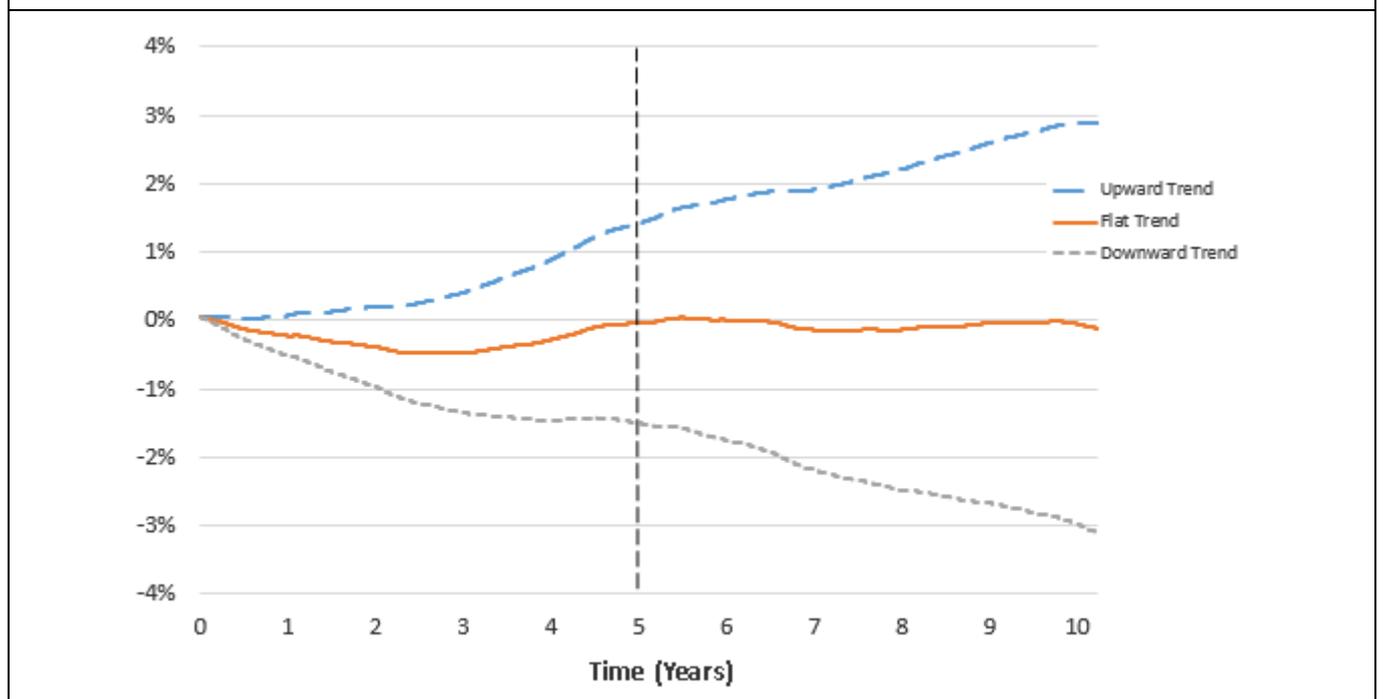
Hypothetical scenarios of future real yields on ILGS

77. Reviewing the rate at a set interval of time would have an impact on the awards claimants receive that depends on when their cases are settled. Three cases are considered, namely, instances when

- real yields on ILGS are trending upwards;
- real yields on ILGS are trending downwards; and
- real yields on ILGS remain fairly constant.

78. Figure 2 shows hypothetical real yields on ILGS for a period of 10 years. It is based on three-year averages, consistent with application of law under the current legal framework, whereby the PIDR is set using the average value of daily real yields on ILGS averaged over the previous three years. The upward and downward trends are applied to the assumed daily yields starting from Year 0. For the 3-year period prior to Year 0 (in order to calculate the average yields shown in the graph up to Year 3), a flat trend in daily yields has been assumed for all 3 scenarios. Fluctuations are consistent with the three year averages seen on ILGS in the past.

Figure 2: Illustrative average real redemption yields on ILGS over a 10-year period



Note: The above chart shows illustrative (fictional) real yields on Index-Linked Gilts, over a 10-year period, with the yield figures shown at any time based on an average of daily yields in the 3 years prior to that time.

79. For illustration, we assume that the PIDR is set at 0% in year 0 and there is a fixed review date 5 years later (see the vertical dotted line in Figure 2). A claimant receives a lump sum at a point some

time before the review, is assumed to invest in ILGS on the day the personal injury compensation is received, and is expected to hold these to redemption.

80. In the scenario outlined above, claimants are awarded a lump sum calculated on the basis that they can achieve a portfolio, of appropriate risk, with a real return of zero percent. In a scenario where real yields on ILGS are increasing (the upward trend in Figure 2), however, the prevailing yields of ILGS available for purchase in the market would be higher than the returns implied by the PIDR. This would work to the claimant's advantage, and would equally disadvantage defendants: If the PIDR is not updated, and yields are on an upward trend, then over time it becomes more likely that claimants are able to achieve a portfolio, of appropriate risk, that exceeds the stream of payments that the lump sum is assumed to produce.
81. The opposite is true in the instance when ILGS real yields are decreasing (the downward trend in Figure 2). In this case, the PIDR would be greater than the rate of return available from investing in ILGS, which would work to the claimant's disadvantage and would equally advantage defendants: If the PIDR is not updated, and yields are on a downward trend, then over time it becomes less likely that claimants are able to achieve a portfolio, of appropriate risk, that generates the stream of payments that the lump sum is assumed to produce.
82. In a scenario where real yields on ILGS remain fairly constant over time, the illustration (flat trend in Figure 2) indicates that the claimant is able to buy ILGS at approximately the real yield indicated by the PIDR set at Year 0. In general, although there will be situations where claimants are able to invest at a higher or lower rate of return than the PIDR, depending on when they receive their award, on average, the total impact on claimants would be broadly neutral. The same would be true for any impact on defendants.

Triggered reviews

83. An alternative could be that reviews are triggered once the yield implied by the underlying investment deviates from the existing discount by a specified threshold. For instance, assuming that the trigger is a move of more than +/-2 percentage points from the existing PIDR, by reference to Figure 2 above:
 - there would be no review over the 10-year period for the Flat Trend;
 - a single review (to +2%) would take place at a point between years 7 and 8 for the Upward Trend; and
 - a single review (to -2%) would take place at a point between years 6 and 7 for the Downward Trend.

Impacts of Option 2

Long review intervals

84. Assuming real ILGS yields are equally likely to rise or fall over any given period going forward, the frequency with which the PIDR is reviewed is neutral with respect to expected compensation.
85. The discussion above shows, however, that the review interval has equity impacts. Longer review intervals do not allow the PIDR to track real yields as closely as shorter intervals. Decreasing the accuracy of the PIDR in this way increases the magnitude of any advantage or disadvantage for claimants, and the numbers of claimants affected. There will be an associated effect on defendants.
86. In addition, long review intervals would amplify equity issues between claimants with similar injuries. While claimants who settle within the review period would be treated equally, under the upward trend in Figure 2, an individual who settles a claim at a point just before the review would receive a different amount of compensation than a claimant who settles just afterwards. When the period

between reviews is a long one, the magnitude of this inequity of treatment could be substantial, leading to a perception of unfairness for claimants.

87. There may also be behavioural impacts that result from reviewing the rate at long fixed intervals. For example, in situations where real ILGS yields are falling, claimants may be incentivised to delay settling a claim in the expectation that a review of the rate will mean they receive a larger lump sum. Equally, in situations where real ILGS yields are increasing, defendants may be incentivised to delay settling in the expectation that a review of the rate will mean their costs are lower. These incentives would increase the longer the interval between reviews as long as the trend persisted because a change in the rate would have a larger impact on the size of the lump sum the claimant receives.

Short review intervals

88. A short interval suffers fewer equity issues than a long interval and, at any given time, is arguably fairer to both claimants and defendants on average. However, short intervals on the time frame of the settlement of a claim may leave claimants and defendants uncertain about what rate to assume during the settlement. While long intervals have strong equity impacts on claimants and defendants, a short interval may add unnecessary complexity to the claim and prolong the negotiation process.
89. Short interval reviews may also be unnecessary where the yield on the underlying investments used to calculate the rate is not expected to be subject to short term changes. The PIDR is intended to reflect the expected rate of return of the claimant's investment portfolio over the term of the award. In the case of a portfolio consisting entirely of ILGS held to redemption, performance is synonymous with yield at the time of the award. The PIDR need only be set according to the values that real yields are anticipated to take before the next review. In the case of a portfolio containing a high proportion of equities, or one in which bonds are traded actively, actual performance over an extended period is uncertain and one is more likely to rely on historical performance to establish a representative PIDR. In this instance, an annual review would be unlikely to result in substantial changes in the rate set.

Triggered reviews

90. The scenario where a review is triggered by a specified percentage point change in the returns on the investments by reference to which the PIDR is set is distinct in the sense that the time interval aspect is no longer of concern. Thus, a review would only take place if it were deemed necessary. The implications of a review based on changes in the performance of a reference instrument is that it can occur at indeterminate points. It could, however, allow for the PIDR to track real yields faithfully and so should quickly correct for cases where the prevailing yield on the underlying investments

deviates substantially from the PIDR in play, minimising the potential for claimants or defendants to be materially disadvantaged.

Option 3: Set up an expert panel appointed to set or advise on what the personal injury discount rate should be

Costs of Option 3

Expert Panel Members

91. It has not been determined whether members of any expert panel would be remunerated for their time. While remuneration would benefit them individually, their number would be so small as to be negligible with respect to the impacts on claimants and defendants of the decisions they make.

Claimants and defendants

92. Claimants and defendants would not be affected by the institution of a panel.

Ministry of Justice

93. There would be a transition cost of setting up an independent panel, which would include recruiting experts and agreeing terms of reference. It is likely that there would be an ongoing cost of salaries and expenses of panel members each time the panel convenes to review the rate.

Third parties commissioned by the panel

94. Depending on the powers granted to the panel (or other decision-maker), it is possible the panel may commission third parties to provide investment data or analysis for informing the decision on what the PIDR should be. Such third parties may incur one-off ICT development costs. The costs of ongoing administration would depend on the mechanism for setting the rate. If, for example, it were decided that the rate should be changed whenever a financial indicator passed a given threshold, relevant third parties might have to maintain a continuous monitoring function.

Benefits of Option 3

Ministry of Justice

95. The Ministry of Justice, and similar bodies in devolved regions, would benefit from the independence of using a panel of experts when setting the PIDR.

F. Assumptions and Risks

96. In this section we outline the assumptions that have been made in preparing the analysis presented above and any risks associated with these.

- We assume the volume of personal injury claims subject to the PIDR will not change under any of the options considered. Claims for which future pecuniary loss is relevant are made regardless of the value of the lump sum expected.
- We assume the volume of claims reaching the latter court stages is constant. The courts are not affected materially by any of the options presented.
- We assume a change in the legal framework under Option 1 will lead to an increase in the PIDR with respect to Option 0. There is a risk that the legal principles provided to the decision-maker, whether the Lord Chancellor or some other body, could occasionally lead to a lower PIDR than under the current legal framework, if, for example, the real yield on ILGS were at a peculiar high.

In these circumstances, the costs to parties outlined in Option 1 would be benefits and vice versa.

- The benefits to wider society under Option 1 in terms of lower insurance premiums is based on the assumption that insurance companies pass their savings from paying out lower lump sums onto consumers.
- There is a risk that some claimants may be unwilling to assume more risk, even if the principles adopted would allow a prudent investor in their situation to bear the assumed risk. Where this happens, the return would not match the PIDR and the individual would run out of money before the expected term of the award. This would lead to more individuals relying on the NHS at the end of their awards with associated costs to the tax payer.
- An increase in the PIDR may make PPOs more attractive to claimants, which would require defendants to take on more risk. This is offset, however, by the reduced lump sums they would pay in other cases.

G. Direct costs and benefits to business calculations (following the Better Regulation Framework and Business Impact Target (BIT) methodology)

97. The change to the way that the PIDR is set under Options 1 and 2 do not qualify as regulatory provisions and do not meet this definition under s22 of the Small Business, Enterprise and Employment Act (2015). Accordingly, Options 1 and 2 would have no direct impact on business for the purposes of the BIT.
98. With regard to s22(3)(a), which defines a regulatory provision in relation to a business activity as one which ‘imposes or amends requirements, restrictions or conditions, or sets or amends standards or gives or amends guidance in relation to the activity’; the guidance the Lord Chancellor is amending solely relates to the court’s role in awarding damages and is not guidance on how to carry out a business activity. While the application of the guidance by courts may have knock-on consequences for business (e.g. lower claims pay-outs by insurers or lower insurance premiums for businesses) this does not mean the Government is giving guidance on business activities.
99. With regard to s22(3)(b), which also defines a regulatory provision as one ‘relating to the securing of compliance with, or the enforcement of, requirements, restrictions’, etc., while the damages that a court awards in a personal injury case might have an indirect effect on business compliance, the court’s role in awarding damages is about compensating the victim rather than ensuring any future regulatory compliance.
100. Changing the identity of the decision-maker under Option 3 would also be out of scope of the BIT, except where the decision-maker would be granted additional powers to gather data from businesses. These costs have not been monetised but could impose transition costs related to ICT development and ongoing costs related to maintaining a monitoring and performance function. It is assumed these costs are modest and below £1m over a ten year horizon.
101. The consultation seeks opinions on the use of PPOs in personal injury claims. PPOs are an alternative to lump sums and insurers are not obliged to offer them, except where ordered to by a court. No change to the regulations underpinning this arrangement is proposed.

H. Wider impacts

102. We have identified that the possible changes under consideration may have equality impacts and that further information is required to assess them. We have identified a range of equality

stakeholders and are seeking their views on the issues generated in the consultation paper accompanying this IA.

Small and micro business assessment (SaMBA).

103. We have carried out a competition assessment and do not anticipate that the choice of the parameters for setting the PIDR will have any competition impact. Any effect will be indirect. The choice of parameters and the rate will apply to all businesses irrespective of their size as any business found liable for a personal injury must pay damages to the claimant.
104. We do not consider that the choice of parameters will affect the operations or performance of small firms or affect them differently from other businesses. This is because the PIDR is applied by the court to its quantification of an established legal liability in personal injury cases, irrespective of the identity of the defendant. Where PPOs are ordered, if any small firms are called on to make such payments as a result of a court case, the court will have decided that the payments are secure. This will inevitably mean that they are being paid by the small firm's insurer rather than the small firm.

Annex A: Types of investment risk

There are different types of risk to be considered when investing in a portfolio. With reference to a zero-risk portfolio, an investor will expect to be compensated for taking on risk by achieving a higher expected rate of return, all other things being equal. The table below summarises various types of investment risk (but is not an exhaustive list), noting that the types of risks claimants will be exposed to will vary according to their characteristics and circumstances:

Risk Type	Description
Default (or Credit)	Where a lender cannot meet the required payment obligations to the borrower (e.g. a bond issuer cannot pay the interest or principal payments) they default on the investment.
Liquidity	If an investor has a need to realise an investment quickly (for cash), it may be difficult to sell the asset immediately. In such cases the asset is said to be illiquid (e.g. property).
Inflation	Where the value of an asset does not keep up with inflation, so that the purchasing power of the asset is reduced.
Currency	If the asset is denominated in a non-Sterling currency, exchange rate fluctuations may depreciate the value of the asset (in Sterling terms)
Market (or Volatility)	The price of any asset will depend on supply and demand in the financial markets. Some assets tend to be more volatile, with greater fluctuations in price.
Longevity (or Mortality)	If an investor lives longer than expected, then they may run out of money if they are exposed to this risk.
Mismatch	When an investor's assets and liabilities are not matched (e.g. the short term income needs of the investor are not met by the income being generated from the asset). In personal injury cases, unexpected expenditure needs may result in a mismatch.
Sequencing	Sequencing risk occurs where one year of below investment returns is immediately followed by another, which is immediately followed by another etc. Poor investment return sequences combine with portfolio withdrawals in a highly destructive way because more fund units need to be purchased to generate the same annual income.
Capital investment	The risk that an investor may lose all or part of the principal amount invested, which may arise from being exposed to a combination of the risks as described above

The following are measures of some of these risks.

Standard Deviation	A standardised measure of investment return variability that reports downside and upside variability together as one number. Standard deviation tells us how tightly the investment returns are clustered around the mean value. When the investment returns are spread apart the standard deviation is larger. When the investment returns are tightly bunched together the standard deviation is smaller.
Drawdown	The amount of capital lost due either to a sequence of falling returns or a single large drop. Drawdown calculates the drop from the highest peak value to the lowest trough value over a given time period of an investment and reports that as a percentage change.
Value at Risk (VaR)	The per cent of capital, or fund value, that's expected to be lost at a given probability level. The probability level of 95% gives an estimate of the value lost at the threshold where 95% of investment returns will be better but 5% worse. So if an investor has a 20 year investment time horizon, 95% VaR tells the investor the loss that is likely 1 year in every 20.
Conditional Value at Risk (CVaR)	The average, or mean, investment return on the portfolio in the worst 5% of the cases. It is a measure of 'tail risk' and focused on the very worst investment outcomes. CVaR tells us "if I do end up in the tail of the 5% of worst investment return outcomes, what is the average loss I will incur".
Downside Variation	The long-run average annual investment return divided by the investment risk (standard deviation), or the investment return earned per unit of downside risk.