Personal Injury Discount Rate – Outcome of Review

Statement placed by the Rt Hon David Gauke MP, Lord Chancellor, in the libraries of the Houses of Parliament on 15 July 2019

1. As Lord Chancellor, I have power under Section A1 of the Damages Act 1996 from time to time to prescribe the rate of return that the Court must take into account when determining the rate of investment return to be expected from the investment of damages awarded as a lump sum in respect of future pecuniary loss in personal injury cases. The Civil Liability Act 2018 amended the Damages Act 1996 by introducing a new methodology to be used by me in setting the rate, and by setting a timetable for this first review conducted under the new methodology, which I have observed in full.

2. In the course of my review, I have considered all the material provided to me, including the advice of the Government Actuary and the Treasury; responses to a Call for Evidence which the Ministry of Justice convened to inform this review; and the Equalities Statement published alongside this Statement. However, at all times I have remained cognisant of my duties under the Damages Act 1996 and have been careful only to take account of those matters that are relevant to my determination of the rate. The process of review has been thorough, reflecting the complexity and importance of the subject matter.

3. This statement sets out the decision I have reached as a result of this exercise and a summary of my reasons for that decision.

Decision

4. **I have concluded that a discount rate of minus 0.25% is the appropriate rate.**

Reasons

5. I emphasise at the outset that, while the reforms enacted last year have provided a clearer legislative framework for this process, the procedure for setting the discount rate remains a complex and technical one. It involves making a series of assumptions and judgements in considering the evidence and economic variables that apply. Some of these judgements are finely balanced and involve making predictions about the future which are inherently uncertain.

6. The rate should be the rate that, in my opinion, a recipient of relevant damages could reasonably expect to receive if they invested their damages award 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 met by the relevant damages; and
   (c) the relevant damages would be exhausted at the end of the period for which they are awarded.

   Together these factors may be said to be the codification of the guiding principle for the award of damages, as set out by the House of Lords in *Wells v Wells* [1999] 1 AC 34 per Lord Hope of Craighead:

   "… *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*".

7. In determining the rate on this basis, the 1996 Act, as amended, requires me to make certain assumptions and to have regard to certain factors, as detailed in paragraph 4 of Schedule A1 to the 1996 Act.

8. I must assume that the relevant damages are payable in a lump sum (rather than under an order for periodical payments), I must assume that the recipient of the relevant damages is properly advised on the investment of those damages, and that they invest in a diversified portfolio of investments. I must also assume that the sums are invested using an approach which involves more risk than very low risk, but less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.

9. I must also have regard to actual returns available to investors, and actual investments made by investors of relevant damages. I must also make such allowances for taxation, inflation and investment management costs as I think appropriate.

10. In arriving at my conclusion, I have had close regard to the expert advice of the Government Actuary. He has set out in his report the full detail of the analytical approach taken, and the evidence from which it was drawn. I highlight certain aspects of the Government Actuary's advice below, but, for the avoidance of doubt, I have considered the entirety of that advice.

11. I consider the Government Actuary's baseline assumption of a representative claimant investing over a period of 43 years to be a reasonable one. It is supported by responses to the Ministry's Call for Evidence, suggesting the average duration for serious personal injury cases was between 40 and 45 years.

12. I consider reasonable the Government Actuary's approach in selecting a representative portfolio (within a range of low risk portfolios), resulting (on his calculations) in a median rate of return of around CPI[1] plus 2% per annum. In adopting this representative portfolio, I consider the suggested division between 42.5% allocation to growth assets (generating higher returns over the longer term): and a 57.5% allocation to matching assets (generating lower returns but offering greater certainty) to be an appropriate one.

13. The advice also addresses how to assess and quantify the effect of tax and expenses for each claimant. I note the caution of the Government Actuary on how this can vary depending on individual circumstances, but nevertheless consider that I must arrive at a reasonable combined figure. I accept the expert advice from the Government Actuary that the expense assumption should correspond with the basis of the investment returns modelled for a representative claimant. This aspect must be taken in the round, and I consider that the Government Actuary's conclusion that a figure of plus 0.75% for tax and expenses is a reasonable one.

14. So far as the effect of inflation on investment returns is concerned, again, I note that the position will vary from claimant to claimant across a spectrum, and the Call for Evidence did not offer a consensus on the impact of damage inflation. I have accepted the expert conclusion of the Government Actuary that a claimant's damages should be assumed (on average, and in general) as inflating by CPI plus 1% per annum.

15. On the baseline assumptions adopted in the Government Actuary's advice (which I consider to be reasonable), the analysis suggests that for a representative claimant the combined expected net return could be reasonably be expected to be plus 0.25%. On the Government Actuary's advice, setting the rate at this level would result in an even (50:50) risk of claimants being under or over-compensated.

16. However, I have regarded that conclusion as a starting point for my determination rather than an end point for the reasons set out below. In doing so I have drawn on the advice from the Government Actuary on projected claimant outcomes and the sensitivity analysis he has undertaken in relation to the data.

17. I consider that a rate of plus 0.25% would run too high a risk of under-compensating claimants. At this level, the representative claimant as modelled by the Government

[1] CPI – Consumer Price Index

Actuary has only an approximately 50% chance of being fully compensated and approximately only a 65% chance of receiving 90% compensation. I consider this to give rise to too great a risk that the representative claimant will be under-compensated, or under-compensated by more than 10%.

18. If I were to set a rate of 0%, the representative claimant as modelled by the Government Actuary would have approximately a 60% chance of receiving full compensation and approximately a 72% chance of receiving at least 90% compensation.

19. However, those are the percentages yielded by the baseline assumptions, and I bear in mind that the Government Actuary's report includes an analysis of the sensitivity of the rate to those assumptions. I consider it reasonable to build in further prudence, when setting the rate, in order to recognise that in any individual case one or more of those baseline assumptions may not apply (either resulting in additional over-compensation or under-compensation), and in particular with regard to the Government Actuary's analysis of the rate as applied to shorter term awards.

20. I note that, on the baseline assumptions, at a rate of minus 0.25%, the representative claimant as modelled by the Government Actuary has approximately a two-thirds chance of receiving full compensation and a 78% chance of receiving at least 90% compensation. Such a claimant is approximately twice as likely to be over-compensated as under-compensated and is approximately four times as likely to receive at least 90% compensation as they are to be under-compensated by more than 10%. I consider that this leaves a reasonable additional margin of prudence which reflects the sensitivities of the rate to the baseline assumptions.

21. In making my determination I have also (as required) considered the projected levels of over-compensation, bearing in mind that the claimant should also have a reasonable expectation that the award will be exhausted at the end of the term of the award. If the rate were set at minus 0.5% then the representative claimant as modelled by the Government Actuary would have approximately a 70% chance of the award not being exhausted at the end of the term and approximately a 20% chance of having more than 10% of the award remaining at the end of the term of the award, and the median expectation is of over compensation of almost 20%. I consider that this gives rise to too great a risk that the award will not be exhausted at the term of the award, or that there may be more than 10% of the award remaining at that time.

22. **For all of these reasons, I have decided that the discount rate should be minus 0.25**%.

23. The Government Actuary has also provided an analysis and developed a working model for me to consider prescribing dual rates. This would involve a lower short

term rate, a switchover period after a set number of years (15 is suggested) and then moving to a higher long term rate. I found the case for a dual rate an interesting one, with some promising indications, particularly in relation to addressing the position of short term claimants.

24. However, I do not consider that it would be appropriate to adopt a dual rate for this review, as at present we lack the quantity and depth of evidence required to conclude that the proposed model would be more appropriate than a single rate. For example, it may be appropriate to assume a different portfolio of investments and a different allowance for tax and expenses for claimants with shorter and longer term awards.

25. I consider that the potential of the dual rate, and its potential consequences (positive and negative) should be explored in more detail, and I have asked my officials to set in train a consultation in due course to examine this in greater depth, and to inform the next discount review and the work of the expert panel who will be advising me.

26. I have considered and noted the possible impact that the prescribing of a single rate may have on protected groups under the Equality Act 2010, but consider any such impact reasonable and justified in the light of all the matters set out above.

The Rt Hon David Gauke MP

Lord Chancellor

15 July 2019