Regulatory Policy Committee

# Reforming the soft tissue injury (whiplash) claims process

## Ministry of Justice

## RPC rating: fit for purpose

## Description of proposal

The Government are concerned about the number and cost of low-value 'whiplash' claims for soft tissue damage from road traffic accidents (RTA) and the impact of these claims on society through increased motor insurance premia. Despite a reduction in the number of road traffic accidents reported to the police and significant advances in vehicle safety, claims remain at a level 50 per cent higher than 10 years ago. The Government believe that the amount of compensation currently paid to claimants for these claims, for pain, suffering and loss of amenity (PSLA), significantly outweighs the level of injury suffered.

The department is consulting on four broad options:

1.1. Remove PSLA compensation for all minor RTA-related soft tissue injury claims with a duration of either:
   a) six months or less or b) nine months or less. Or:

1.2. Introduce a fixed sum of compensation for minor RTA-related soft tissue injury claims where the injury duration is either:
   a) six months or less or b) nine months or less.

2. Introduce a fixed tariff system for PSLA compensation amounts for soft tissue injuries with a duration of either:
   a) greater than six months or b) greater than nine months.

3. Raise the small claims limit to £5,000 (from £1,000) for either:
   a) all personal injury (PI) claims or b) RTA claims only.

4. Require medical reports to be produced for every soft tissue injury claim.

The Government's current preferred options are a combination of options 2a, 3a and 4 with either option 1.1a or option 1.2a. The first combination is referred to as option 5.1 in the impact assessment (IA) and the second as option 5.2.

## Impacts of proposal

Based upon data from the Department for Work and Pensions' Compensation Recovery Unit, the number of RTA-related personal injury claims settled in 2014/15

was 702,000. Of these, 523,000 related to soft tissue accidents and involved a financial settlement. The number of claims has remained broadly constant in recent years despite a reduction in RTAs reported to the police and advances in vehicle safety.

The main beneficiaries of the proposal are defendants (insurance companies). The department expects these savings to be passed ultimately to consumers through lower motor insurance premia. The main losers are individuals (claimants), who would either no longer be able to make a claim or would receive a lower payment.

The department uses a number of data sources to estimate the impacts of the proposals. In addition to DWP data on claims, the department draws upon, for example, databases used by insurers, evidence from a major insurer, information from the Association of Medical Reporting Organisations and data from a leading panel law firm. Claims outcome data for 2015 have been used to estimate weighted averages of PSLA damages awarded. These figures are used to estimate the costs and benefits of the proposal. The consultation document additionally includes, for comparative purposes, the thresholds for damages from the 12th edition of the Judicial College guidelines. The 13th edition of the guidelines, published in September 2015, uprates the thresholds, with a significant increase at the lowest band. The department has, however, explained that it considered the 12th edition thresholds to be more appropriate to present alongside the figures used in the IA, which are based on data covering the whole of 2015.

Net present value (NPV) estimates

Taking each option in isolation, option 2 is expected to have the largest impact because the proposed tariff system sets compensation levels well below current average amounts. This results in an effective transfer of £581 million from claimants to defendants each year (albeit resulting in an NPV of zero).

Option 1.1 produces gross savings of £532 million each year for defendants, mainly by removing PSLA compensation in respect of around 220,000 claims. This exceeds the loss to claimants (£413 million) because some of the benefit to defendants comes from legal fees avoided and expenditure on medical report costs (in respect of claims that can no longer be made). This option has a positive NPV (£761 million) because losses to lawyers and medical experts are not included as a cost in the NPV calculations (see comment in 'Quality' section below).

Option 1.2 produces gross savings of £504 million each year for defendants. The savings to defendants are lower than in option 1.1 as a result of PSLA compensation continuing to be paid in respect of 68,000 claims, at an average of £411 per claim.

This average is based on a proposed fixed compensation of £400 per claim, with an additional £25 if the claim has a psychological element.

Under option 3, contested PI claims under £5,000 would proceed through a small claim tribunal (SCT) rather than the existing 'fast track' process. It would apply to 96 per cent of RTA claims. Recovery of costs by the successful party is strictly limited under the SCT; claimants would, therefore, be responsible for their own legal costs. The resultant savings to defendants are estimated at £419 million each year. These costs are transferred to claimants (£130 million) and 'before the event' (BTE) insurers (£247 million), who would also no longer be able to recover costs from defendants. There would also be a loss of income to lawyers and medical experts. These are treated in the same way as above, resulting in an NPV of £286 million for this option.

The increase in the number of medical reports under option 4 would result in additional costs to defendants, not just through paying for medical report fees but also from associated higher PSLA and special damages, and legal fees. This cost is estimated at £102 million each year. The main beneficiaries are claimants; the requirement for medical reports in all cases is estimated to increase compensation payments by £65 million each year. In a symmetrical treatment with options 1 and 3, the additional income to medical experts and lawyers is not included in the NPV calculations. The overall NPV of this option is -£347 million.

The impact of options 5.1 and 5.2 is less than the sum of the estimates for options 1-4 because the options overlap. For example, options 1.1/1.2 or 2 would reduce the number or size of claims, significantly reducing the impact of options 3 or 4. Overall, options 5.1 and 5.2 are estimated to have an annual average cost of £1.4 billion and an annual average benefit of £1.5 billion. The overall NPV is estimated at £780 million.

Business impact estimates

As indicated above, in general terms, the beneficiaries of the proposal are businesses (defendant insurers) and the losers individuals (claimants). The department, therefore, currently estimates a net direct benefit to business of £1.3 billion each year. This consists mainly of the following savings:

- £402 million from the removal of PSLA damages for claims where the injury duration is less than six months (218,000 claims affected). (£372 million under option 1.2, where there is PSLA compensation of £400.)
- £563 million from the fixed tariffs for PSLA damages for claims where the injury duration is greater than six months (361,000 claims affected).

- £291 million in reduced legal fees (mainly from an estimated 407,000 claims that have legal representation and fall under the SCT cost provisions).

The proposal appears to be a qualifying regulatory provision that should be accounted for under the business impact target.

## Quality of submission

The department has provided sufficient analysis for the consultation stage, with extensive monetisation of impacts. The department's occasional use of anecdotal evidence to support some of its assumptions around key drivers of cost and benefit is acceptable at this stage. However, the RPC expects the department to use consultation to improve the evidence base for the final stage IA. There are also some specific areas where the IA could be improved and issues that the department will need to address at the final stage. These are described immediately below.

Treatment of revenue loss , e.g. to claims lawyers and medical experts

The overall positive NPV appears to be as a result of excluding the loss of (or gain in) revenue to some groups, mainly lawyers and medical experts from the NPV analysis. The department states that "…*this methodology is in line with standard practice for calculating the effects of changing demand on suppliers*" (paragraph 2.6, page 15). The £402 million and £563 million direct benefits to business from options 1 and 2, referred to above, appear, therefore, to be net of revenue losses to lawyers and medical experts.

There appear to be two alternative ways of viewing the loss of revenue to claims lawyers and medical experts that arises from the reduction in claims:

First, that the revenue itself comes from compliance with a regulatory system and, therefore, a reduction in this revenue should not be counted as a cost to business or society. There is, in effect, a saving to society from resources previously absorbed by regulatory activity now being available for productive use elsewhere in the economy. Although not described by the department in this way, this appears to be the approach that has been used for the NPV analysis. It also seems consistent with how the department has assessed the impact of previous whiplash reforms, where lawyers and medical experts facing reduced claims were assumed to "*reallocate their resources to other profitable activities*".[1] (In that IA, however, all of the impacts resulting from reduced claims were treated as indirect – see comment below.)

Second, that the revenue to claims lawyers and medical experts comes from normal market activity and the proposal restricts this activity. The loss of revenue should,

[1] RPC opinion RPC14-MOJ-2141(2) 29 September 2014.

therefore, count as a direct cost to business. This appears to be the approach used for the equivalent annual net direct cost to business (EANDCB) analysis.

The first approach is clearly appropriate in relation to fraudulent or exaggerated claims. The department suggests, and provides some limited evidence, that these form a significant proportion of total claims. In these cases, the business generated for lawyers etc should not be treated as normal market activity and should not, therefore, be counted as a cost to lawyers if it is lost. It is also clearly appropriate in relation to the increase in revenue to medical experts resulting from the requirement for all claims to have a medical report (option 4). The gain in revenue to medical experts should not be used to offset the cost to defendant insurers of paying for the report. However, it is not straightforward to judge which of the two approaches is appropriate in relation to the other proposals, particularly options 1 and 2 which directly prevent or limit the value of (genuine) claims.

At the final stage, the department will need to explain and justify further the treatment of these impacts in both the NPV and EANDCB analyses. Unless the department can justify why a different treatment between the two analyses is appropriate, a consistent treatment should be adopted. The RPC would be happy to discuss prior to submission of the final stage IA.

Classification of impacts as direct/indirect and treatment of 'pass-through'

The department acknowledges that part of the £291 million benefit in reduced legal costs from option 3, referred to above, could be indirect (paragraph 4.2, page 82). This appears to refer to the £69 million that would come from a reduction in the number of claims, as claimants are deterred by no longer being able to recover their legal costs. This seems to be a similar effect to that cited in previous reforms, where the department assessed benefits to businesses as indirect because they resulted from assumed responses by claimants, for example in making fewer or less-exaggerated claims. The department will need to ensure that its EANDCB figure at the final stage includes only direct impacts on business.

In terms of the remaining £222 million benefit to defendants, there appears to be a corresponding £189 million loss to BTE providers, who are no longer able to recover their legal costs from defendants. The department assumes that BTE providers would pass this cost on to consumers (paragraph 2.214, page 60). However, in line with the approach elsewhere in the IA, pass-through is an indirect effect. It appears, therefore, that the cost to BTE providers should be considered a direct impact on business and reflected in the EANDCB figure. Similarly, a substantial proportion of the saving to defendants from not having to pay VAT on legal costs would seem to be a cost transfer to BTE providers. Any transfer of this to consumers would be, as

stated at paragraph 2.113 (page 43) "*secondary*" (and, therefore, indirect for business impact target purposes). The department must ensure that its EANDCB figure at the final stage does not exclude impacts on BTE providers on the basis that they are passed on to consumers.

Baseline

The IA appears to project forward the number and value of soft tissue injury claims in 2014/15 as the baseline for the analysis (paragraph 2.3, page 15). The IA includes sensitivity analysis on an increase and decrease in the baseline volumes. However, the IA would benefit from presenting more information on the trend in claims to justify the central scenario of claims being unchanged from 2014/15 levels. In particular, given that claiming is optional and driven by the likelihood of being successful, as these proposals would reform the claims regime, this would alter the behaviour of potential claimants and, therefore, change the number and nature of claims. Furthermore, as noted in the IA (page 9), between October 2014 and June 2016 the Government implemented a series of reforms to reduce the number and cost of whiplash claims. The impact of these policies will not yet be fully reflected in the claims data. Further, the department's IA on these reforms indicated that they would generate a benefit to business of approximately £190 million each year. At the final stage, the department will need to show that its baseline, against which the EANDCB will be calculated, reasonably reflects likely trends in claims and the expected impact of these reforms.

Rationale and options

The IA provides a reasonable discussion of the rationale for government intervention (pages 10-12). The IA covers a range of options and explains that non-regulatory options, such as working with claimant and defendant representative groups, could not achieve the policy objectives. The department states that it has become culturally acceptable in some quarters to make trivial, exaggerated or fraudulent claims. The department sets out the different phases of the Government's 'soft tissue reform programme' (page 9) and states that the present proposals build upon this (paragraph 1.12, page 11). The IA would benefit from explaining further why it is desirable to do this now rather than wait to see the impact of the recent reforms.

Option 4 is presented as having a significant negative NPV. Given this, the department should explain further why option 4 is included in the preferred policy package. In particular, the IA should discuss further the wider social and economic benefits of this option (paragraphs 2.180 – 2.181) and how far this option is instrumental in achieving the benefits of the whole policy package.

Option 1.2 (and 5.2)

This option is an alternative to option 1.1 (and 5.1) and provides for a fixed sum for compensation of £400, with an additional £25 if a claim has a psychological element. This compares to around £1,850 for the median gross PSLA compensation awarded in 2015. However, as noted above, this option involves approximately a £30 million reduction in the annual benefit to business compared to option 1.1. This appears to be a result of the assumption that only 35 per cent of low-value claims would still be made. This is the same assumption used for option 1.1, where it is assumed that a proportion of claims that include 'special damages' would still be made. ('Special damages' refer to any direct financial loss as a result of the injury, such as loss of earnings or payment for the cost of medical treatment. Claimants are entitled to recover these even under option 1.1.)

The department acknowledges that more than 35 per cent of low-value claims could proceed under options 1.2 and 5.2, given that £400 PSLA damages is still available for low-value claims (paragraph 2.260, page 76). It also conducts sensitivity analysis on this percentage, as part of its 'risks and sensitivity analysis' section (pages 76-81). Nevertheless, it seems likely that the percentage of claims continuing would be higher under option 1.2 than under option 1.1, and that the benefits to business would, therefore, be reduced more significantly than that estimated. The final stage IA will need to justify its central assumptions.

In addition, in contrast to option 1.1, where minor value PSLA claims are effectively removed, the department may be assuming under option 1.2 that claimants are deterred from proceeding with claims by the much lower compensation available. If so, it may be the case that the benefit to business from this (as opposed to the benefit from the lower compensation limit itself) is indirect because it depends upon the reaction of potential claimants. The department will need to address this for the final stage.

Consultation evidence

The department's final stage IA should address comments received during consultation, including any relating to the new Judicial College guideline thresholds published in September 2015. The final stage IA will need to demonstrate that it has used the latest available data, or explain why it is not proportionate or appropriate to do so, for the RPC to be able to validate an EANDCB figure.

Presentation

The IA would generally benefit from providing clarification of how some of the figures used later in the document relate to similar figures earlier in the IA. In particular, further explanation of how the estimates for options 5.1 and 5.2 use the figures for each of options 1-4 would be useful.

Small and micro business assessment

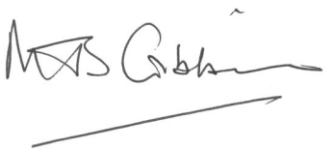
The proposal is of domestic origin. A small and micro business assessment is, therefore, required. Although the proposals are highly beneficial to business overall, some businesses would be expected to face a reduction in demand for their services as the number of soft-tissue RTA claims is reduced. The department's assessment, using data from the Law Society, suggests that at least 95 per cent of law firms undertaking PI work and around 98 per cent of claims management companies are likely to be small or micro businesses. The department, therefore, explains that any exemption for small businesses would lose a large proportion of the benefits of the policy. The large majority of the cost of the policy is borne by individuals rather than small or micro businesses. Nevertheless, given the potential impact on small legal firms and claims management companies, the department should seek to use consultation to strengthen the assessment at the final stage.

**Departmental assessment**

| | |
|---|---|
| Classification | Qualifying regulatory provision |
| Equivalent annual net direct cost to business (EANDCB) | -£1.2 billion |
| Business net present value | £10.5 billion to £10.8 billion |
| Societal net present value | £0.78 billion |

**RPC assessment**

| | |
|---|---|
| Classification | Qualifying regulatory provision |
| Small and micro business assessment | Sufficient |



**Michael Gibbons CBE,** Chairman