



Ministry  
of Justice

# **Personal Injury Discount Rate**

Response to the Report of the Justice Select  
Committee

Draft Clause

March 2018

Cm 9567



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of Justice

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Response to the report of the Justice Select Committee

Draft clause

Presented to Parliament

by the Lord Chancellor and Secretary of State for Justice

by Command of Her Majesty

March 2018



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## Introduction

1. The Government welcomes the publication of the Justice Select Committee's report *Pre-legislative scrutiny: draft personal injury discount rate clause*.<sup>1</sup> The Government is grateful to the Committee for its prompt and detailed consideration of the draft legislation, which was published by the Ministry of Justice in its paper *The Personal Injury Discount Rate How it should be set in future Draft Legislation* on 7 September 2017.<sup>2</sup>
2. The Government recognises that the setting of a discount rate for use in personal injury cases is not a straightforward exercise and that the outcome is very important for those affected. Individuals who have suffered life changing injuries because of the wrongful actions of someone else are likely to be dependent on the award to meet the costs of their care and other financial losses arising from the injury. These individuals deserve compensation that meets their expected needs. The discount rate is an important part of calculating that compensation. The Government's overall objective remains to create a fairer and better system for the setting of the discount rate. With this objective in mind we have carefully considered the Committee's report and thank the Committee for its comments and recommendations, many of which the Government has chosen to adopt. The Government's detailed response to the Committee's comments and recommendations is set out in Part 2 of this paper.
3. The Government is also grateful to the individuals and organisations (listed in the Annex to this paper) who provided substantive and drafting comments on the draft legislation directly to the Ministry of Justice. Their comments have been carefully considered and taken into account by the Government when considering the comments and recommendations of the Committee. The Government's response to the additional points raised by stakeholders, but not by the Committee, are included at the appropriate points in this response document.

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<sup>1</sup> Third Report of Session 2017-19 HC 374 published on 30 November 2017.

<sup>2</sup> Cm 9500.

## Background

4. A lump sum award of damages for future pecuniary loss is intended to compensate the injured person for all the loss expected to be suffered by him or her as a result of the injury, neither more nor less. The aim is to provide full compensation and, in so far as a sum of money can do so, to put the claimant in the same position as he or she would have been in but for the injury. This is known as the 100% compensation principle.
5. The purpose of applying the personal injury discount rate in the calculation of the lump sum is to adjust the size of the award for the return expected to be earned on the lump sum before it is expected to be spent in meeting the losses and costs assessed in the court order or settlement agreement as flowing from the injury. If the discount rate applied is greater than the rate of return actually received by a claimant, the claimant will in the end receive less money from the award than was expected at the time it was made: conversely, if the rate of return received is greater than the discount rate applied, the claimant will receive more than was expected at that time. The discount rate neutralises the return expected from the investment of the lump sum in the calculation of its size.
6. Under the Damages Act 1996 the rate to be taken into account by the court in assessing the rate of return to be expected is set by the Lord Chancellor on the basis of principles set out in caselaw, principally the decision of the House of Lords in *Wells v Wells*.<sup>3</sup> Under these principles the injured person is assumed to be a very cautious investor who has the objective of meeting his or her losses in full as they arise and without delay, reflecting the fact that he or she may be financially dependent on the lump sum awarded for the rest of their lives. The House of Lords in *Wells v Wells* therefore viewed claimants in serious personal injury cases (e.g. people with serious injuries or facing a life of suffering due to the negligence of others) as different from other, ordinary, investors because they are required to invest their settlements to secure their future financial position rather than merely investing to obtain a higher rate of return. This led in practice to the rate being set largely by reference to returns on Index-Linked Gilts (“ILGS”), even though the evidence from the research and consultations carried out by the Ministry of Justice shows that claimants generally invest in low risk diversified portfolios not in ILGS alone.
7. The Government accordingly believes the assumptions made by the present law on the setting of the discount rate as to how claimants invest are unrealistic and produce significantly larger awards than are necessary to provide 100% compensation. This has a significant effect on taxpayers through the additional cost of personal injury settlements paid by the National Health Service and other public sector bodies; and businesses and individual consumers through higher insurance premiums. The framework for setting the discount rate therefore needs to be re-calibrated to better achieve its objective of 100% compensation.

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

8. To remedy this problem and to improve other aspects of the law relating to the setting of the discount rate the Government published draft legislation setting out proposals for how, when and by whom the discount rate should be set. Those proposals are summarised in the text box below.

- a. The rate will be set by reference to expected rates of return on a low risk diversified portfolio of investments rather than very low risk investments as at present. Low risk is less risk than would be taken by an ordinary prudent investor and more risk than very low risk.
- b. The rate will be reviewed promptly after the legislation comes into force and, thereafter, at least every three years.
- c. The rate will be set by the Lord Chancellor following consultation with an expert panel (other than on the initial review which would be by the Lord Chancellor with advice from the Government Actuary) and, as at present, HM Treasury.

9. In relation to the proposals the department explained in the paper publishing the draft legislation that:

“Under the new law the discount rate will reflect the rate of return to be expected on a low risk diversified portfolio. There will probably be a range of portfolios and rates of return that might be used in the setting of the rate. It will be for the Lord Chancellor to apply the legal principles set out in the legislation and on that basis to decide where in the range of low risk the rate should be set.

The key legal principle will be that the rate should be the rate that, in the reasonable opinion of the Lord Chancellor, a properly advised recipient of a lump sum of damages for future financial loss could be expected to achieve if he or she invested the lump sum in a diversified low risk portfolio with the aim of securing that (a) the lump sum and the income from it would meet the losses and costs for which they are awarded when are expected to fall; and (b) the relevant damages would be exhausted at the end of the period for which they are awarded. In this exercise, the Lord Chancellor must consider the investments available and actual investments made by claimants; and must make such allowances for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate.”<sup>4</sup>

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<sup>4</sup> Cm 9500



## Response to recommendations

10. The Committee's report contains a detailed scrutiny of the draft legislation. In brief, the Committee's main conclusions in relation to how, when and by whom the rate should be set were as follows. In relation to how the rate should be set, the Committee welcomed the Government's commitment to full compensation but asked that it be clarified. The Committee recommended that more evidence be gathered before legislation was introduced to change the basis on which the rate is to be set, or alternatively that a power should be taken to amend the relevant assumptions in due course. The Committee was also concerned that there should be sufficient safeguards to protect the most vulnerable claimants from significant under-compensation and that there should be mechanisms for obtaining evidence and measuring the effect of changes in the rate. In relation to when and by whom the rate should be set, the Committee agreed that if the rate was to be set by reference to a low risk portfolio, the introduction of regular periodical reviews was necessary; and agreed the rate should be set by the Lord Chancellor with the assistance of an expert panel. The Committee recommended that the expert panel should be involved in every review of the rate, including the first. The Committee also made a number of recommendations to increase the transparency of the process, primarily requiring the Lord Chancellor to provide reasons for the rate set and to make public the views of the expert panel.
11. The Government shares the Committee's concerns that individuals receiving damages for serious personal injuries should receive proper compensation and that the discount rate should be set with the objective of full and fair compensation. The Government has carefully considered the report and in response to the Committee's recommendations, the Government will:
  - Involve the expert panel in the first review of the rate under the new framework.
  - Work to develop further the existing evidence base ahead of setting the rate in the first review by:
    - a. Issuing a further call for evidence on the details of investment behaviour, including evidence about investments by or on behalf of persons with protected characteristics;<sup>5</sup>
    - b. Commissioning the Government Actuary's Department to carry out further research and analysis of the assumptions to be made about inflation, tax and management costs; and
    - c. Commissioning the Government Actuary's Department to carry out further analysis considering the effect of a range of rates under a wider range of assumptions – for example, as to the length of awards.
  - Require the Lord Chancellor to give reasons for the rate chosen on a review.

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<sup>5</sup> The "protected characteristics" under the Equality Act 2010 are: race, sex, disability, sexual orientation, religion and belief, age, marriage and civil partnership, gender reassignment, pregnancy and maternity.

- Require the Lord Chancellor to consult the panel about the allowances to be made for taxation, investment management charges and inflation in the setting of the rate.
  - Require the Lord Chancellor and the panel to consider the possibility of setting different rates for different cases on each review.
  - Publish the panel's report to the Lord Chancellor at each review.
  - Publish an impact assessment of the effect of the change in rate every time the Lord Chancellor changes it.
  - Amend the legislation to make clear that it is possible on any review for the Lord Chancellor to set differential rates on the basis of duration or heads of loss.
  - Explain more clearly the meaning of the 100% compensation principle.
  - Explain more fully why the setting of the rate is not dependent on balancing social costs with the level of compensation.
  - Provide or endorse guidance on standard practice to help ensure claimants properly understand the choice between a lump sum and a periodical payment order.
  - Investigate the quality and effectiveness of current advice on the choice between a lump sum and a periodical payment order.
  - Investigate whether there are ways in which the use of PPOs could be increased.
  - Investigate whether a mechanism could be created to keep those responsible for setting the rate informed about investment behaviour.
  - Consider whether the government or a third party should review whether investment management costs should be recoverable as a head of damages.
12. The Government agrees with the Committee that the reforms to the setting of the discount rate should be based on good evidence of the way that claimants invest and that this evidence should be interpreted taking into account the effect that the circumstances in which the investment decisions were made may have had on the choice of investments. The Government does not, however, accept the Committee's view that the Government's evidence is insufficient to justify proceeding with the proposed reforms. It is clearly the case that basing the rate on average returns from Index Linked Gilts is not realistic. There is good evidence that claimants generally invest in diversified low risk investments. Each review will, however, have to be carried out on the basis of up to date evidence and analysis. To help prepare for the first review of the rate under the new law, which will follow shortly after the relevant legislation comes into force, the Government will call for evidence of investments made by claimants and the investments available to them and arrange for further analysis of the returns likely to be obtained during the passage of the Bill. The first review will then be able to be carried out with the benefit of up to date evidence and analysis.

## How the rate should be set

### Achieving “full compensation” for claimants

13. The Committee recommended **that the Government clarifies what it means by 100% compensation. In practice, a lump sum award will nearly always either under- or over-compensate claimants. Some will receive too much and some too little. If the Government is targeting a median level of 100% compensation in relation to interest earned on lump-sum investment, it needs to say so.** (para 24)
14. **The Government welcomes the opportunity to clarify further what it means by 100% compensation in the context of setting the discount rate.** The Government wants individuals who are unlawfully injured to receive compensation that meets their expected needs fully and fairly. The Government’s understanding of the purpose of an award of damages for personal injury and the 100% compensation principle is described in the following text box.

The civil legal remedy for wrongfully inflicted personal injury is usually an award of damages. The award will be to cover all the losses flowing from the injury, whether they be past, present or future, certain or contingent. Examples of damages for future loss or expense include compensation for loss of earnings, care costs, case management costs and medical expenses. These future losses and expenses may in some cases run for many years into the future.

The award for future loss or expense may take the form of a lump sum, periodical payments or a combination of both. A lump sum award should be exhausted at the end of the period for which it is given. Periodical payments should run for the period that the anticipated loss or expense in question is expected to continue or until the death of the claimant, if that is earlier. On the other hand, if awarded for life, actual longevity may exceed expected longevity at the time of the award.

The overall aim is that the award as a whole, whether lump sum or periodical payments or a combination of both, will neither under-compensate nor over-compensate the claimant. As Lord Hope of Craighead said in *Wells v Wells*: “...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...”.

This is the “100% rule”. Achieving full compensation may sound a precise formulation but the assessment of damages can never be an exact science, particularly in matching future loss, where predictions have inevitably to be based on assumptions as to what may happen in the future.

15. The Government's view is that the discount rate is intended to support, as accurately as it can, the achievement of the overall objective of 100% compensation. As explained, the rate does this by adjusting the size of the lump sum for future loss (which is calculated by the court or the parties to the litigation to represent all the losses and costs expected to be incurred by the claimant as a result of the injury) to allow for the income that the claimant is expected to receive from it before the relevant losses or costs fall due for payment. In theory, the returns earned by the claimant will match the discount rate applied. In practice, as was indicated in the consultation paper, this is almost certain not to be the case no matter at what level the discount rate is set. What is predicted may not match what happens in the future. In addition, the discount rate is only one element in the calculation of a lump sum award of damages for future pecuniary loss. The amount of anticipated costs and losses may turn out to be inaccurate. There are also many other factors, outside the scope of a review of the discount rate, that can influence the initial size and ultimate adequacy of an award, such as the longevity of the claimant and his or her investment choices.
16. The Government accordingly agrees with the Committee that in practice a lump sum award will nearly always either under- or over-compensate claimants as against the future losses anticipated in the making of the award. The Government's view is that the objective of 100% compensation must be interpreted in the light of this reality. A prescribed discount rate applying to all or even a class of cases is a relatively blunt instrument that cannot be expected to deliver absolute accuracy across all circumstances. Such a rate is, however, still a significant aid to the better and more efficient settlement of personal injury claims.
17. The Government's expectation is that the new approach to the setting of the rate will, relative to the approach of the present law, produce a higher discount rate and lower lump sum awards for future loss. The Government appreciates that claimants may consider any reduction in the sums payable to be contrary to their interests, but the purpose of the 100% compensation principle is to provide a reasonable estimate of full and fair compensation, rather than to maximise the actual sums of money payable.
18. In relation to the Committee's question as to whether the Government is targeting a median level of 100% compensation, the Government is not doing so. To target the median claimant would be to expect the investments of half of all claimants in receipt of lump sum awards for future financial loss to under-perform the discount rate. Equal numbers of such claimants would be under and over-compensated relative to the returns expected under the proposed discount rate. This is explained in the Government Actuary's Report.<sup>6</sup> The Government considers that this level of expected under-compensation would be inappropriate. The Government accepts, of course, that different discount rates will, in relation to the returns to be expected from a low risk portfolio of investments, produce different ranges of expected investment outcomes for claimants. Some claimants will be expected to achieve higher returns than the discount rate and some will be expected to receive lower returns. The Government does not intend to specify exactly what the balance between under- and over-compensation should be. It will be for the Lord Chancellor taking into account

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<sup>6</sup> Government Actuary's Department Ministry of Justice Personal Injury Discount Rate Analysis. See, for example, paragraph 6.6, Table 10 <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>

the advice of the expert panel and HM Treasury to decide what the rate should be. The Government anticipates that the review process will involve identifying a range of rates within the statutory framework from which a rate can be selected that is expected to produce a reasonable and fair outcome for claimants who take their compensation in the form of a lump sum rather than as a periodical payment. Periodical payments pass investment risk to the defendant and so avoid many of the issues associated with lump sums. Periodical payment orders are discussed further below.<sup>7</sup>

19. As explained in the analysis published by the Government Actuary's Department's the distribution of under and over compensation will vary with the underlying rates of return and discount rate proposed and some degree of anticipated over and under compensation is inevitable given the adoption of a "low risk" investment approach by reference to evidence of actual investment practice.<sup>8</sup> However, even the "very low risk" approach assumed under the current legal framework will not avoid over and under compensation, as the circumstances of individual claimants may not match the availability of Index-linked Gilts and there may be unexpected changes in their financial needs. The Government's view is that the best way to ensure that the prescribed discount rate contributes effectively to the delivery of full and fair compensation for claimants generally is not to select a pre-determined or more specific criterion for identifying where within the permitted range the discount rate should lie. This choice of where the rate lies should instead be a matter of judgement for the Lord Chancellor to make in the light of the circumstances prevailing at the time of the review. **The Government is therefore not targeting a median level of 100% compensation. Instead, the Government's intention is that whether by lump sum or periodical payment order (or a combination of both) claimants should receive the money that they are expected to need and that the setting of a prescribed discount rate should contribute to this by providing a fair and reasonable estimate of the return that should be expected to be earned on a lump sum award of damages for future financial loss.**

### Are claimants being over-compensated?

20. The Committee recommended that **"the Government find a means of assessing whether the legislative framework is compensating claimants fairly for their losses; otherwise by increasing the discount rate to remove what it sees as one type of "over-compensation" (primarily over-compensation due to greater than anticipated earnings from lump-sum investment), it may be simply increasing levels of under-compensation for claimants who were already under-compensated."** (para 33).
21. The Government shares the Committee's concern that claimants should be properly compensated for the losses caused by the injuries they have received. The Government also wishes to make clear that in relation to the discount rate, references to over and under compensation describe outcomes relative to the return implied by the discount rate in question. Claimants are assumed to invest their lump sum for the purposes of setting the rate, but their actual returns are determined by many factors

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<sup>7</sup> See paras 45 to 52.

<sup>8</sup> Personal Injury Discount Rate Analysis (July 2017). See, for example, Table 10 in paragraph 6.6. <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/> .

including their own actions to protect themselves against mortality, investment and other risks over the long-term.

22. The discount rate is only one element of the legal framework for compensating claimants. Its purpose is to provide a measure that the court (and indirectly the parties to the litigation or dispute) can take into account in determining the return to be expected from investing a lump sum award for future pecuniary loss. If the rate is a reasonably realistic estimate of that return, excessive under and over-compensation by reason of the level of the discount rate will be avoided. **The Government accepts that the setting of a discount rate is not a precise science and that there may be a range of appropriate rates within which the rate can be chosen, but the introduction of regular periodic reviews based upon evidence of investment practice will provide a mechanism by which the operation of the discount rate can be reviewed and its level adjusted regularly to ensure it remains as accurate as possible.**

### Relevance of investment behaviour in setting the rate

23. The Government proposed that in determining the rate the Lord Chancellor must have regard to the actual returns that are available to investors and to the actual investments made by investors of relevant damages.<sup>9</sup> The Committee made a number of comments regarding the use of evidence of actual investments in the setting of the rate.

**“It may seem intuitive that the discount rate should reflect actual investment behaviour. But we conclude that this proposition should not be adopted without some further critical examination.” (para 37).**

**“We advise caution in considering evidence of claimants’ investment behaviour to set the discount rate. Investment by claimants in higher risk portfolios could indicate they are under-compensated and forced into higher-risk investments to generate sufficient return for their future living expenses.” (para 41).**

24. The Government accepts that different methodologies can in principle be applied to calculate a discount rate. **However, the Government considers that in personal injury cases the discount rate should be a fair assessment of the rate of return realistically to be expected from the investment of a lump sum award of damages for future financial loss and that evidence of actual and available returns from investments is relevant to that process.** The Government’s evidence shows, however, that the present system for setting the rate, which is based on a “risk free” approach,<sup>10</sup> tends to create excessively large awards of damages (as explained in the command paper publishing the draft legislation, the impact assessment and the report from the Government Actuary published at the same time).<sup>11</sup> The Government’s assessment of the situation was well supported in the response to the consultation paper ‘The Personal Injury Discount Rate: How it should be set in future’ published jointly by the Ministry of Justice and the Scottish

<sup>9</sup> Cm 9500 para 5

<sup>10</sup> *Wells v Wells* [1999] 1 AC 345

<sup>11</sup> <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>

Government on 30 March 2017.<sup>12</sup> The Government notes that two of the leading legal textbooks on the subject of damages have expressed the view that the discount rate should move away from being based on returns on Index Linked Gilts towards the investments that claimants actually make.<sup>13</sup>

25. **The Government remains of the view that the basis for setting the rate should move away from the current unrealistic “no risk” approach. However, it accepts that investment behaviour will be influenced by various factors and that the assessment of evidence of past investments in the review process should consider the reasons why such investments were made. The Government considers that the introduction of an independent expert panel into the process for the review of the rate will provide assurance that the investment practice of claimants is properly understood and considered.**

### Are claimants investing in low-risk diversified portfolios?

26. In concluding its examination of whether claimants invested in low risk diversified portfolios, the Committee stated: ***“It may be reasonable to change the assumptions upon which the discount rate is currently calculated if they are indeed no longer representative of “real world” behaviour. However, we do not believe the evidence presented on this point so far is adequate. We recommend that clear and unambiguous evidence is gathered about the way claimants invest their lump sum damages before legislation changes the basis on which the discount rate is calculated.” (para 53).***
27. The Committee also made an alternative recommendation (see text box below).<sup>14</sup>

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<sup>12</sup> <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>

<sup>13</sup> *McGregor on Damages* 20.ed.(2018) para 40-126 “.... It is thought that the time has come to return to a sense of normality and this can only be done through an abandonment of gearing awards to the returns on ILGS.” *Kemp and Kemp on Damages* para 4-075 “.... But the enthusiasm ... for Index-Linked Gilts faces the logical difficulty that it is based on an obvious fallacy: a claimant with a large sum of money will in fact never actually invest his money in that way. ... It follows that using ILGs as a proxy for preserving the value of money over time is justifiable only in theory and not in practice.

<sup>14</sup> Part 6 of the Third Report of Session 2017-19 HC 374 published on 30 November 2017.

**If the Government remains convinced that it must change the assumptions it makes about how damages will be invested, to adjust the balance between the interests of different groups of society, it should say so. In that case, we would recommend that the Government: a) undertake careful and representative research into the way claimants invest their damages, the reasons for their choices and the extent to which they obtain fair compensation, and with the benefit of that research review the legislation at an early stage to consider: i) how its impact on claimants is reflected in the balance the legislation strikes; and ii) whether to exercise the power to amend the assumptions by regulations which we recommend below; and b) amend paragraph 4 of the Schedule inserted by the draft Clause so that: i) the investment approach is assumed to involve the lowest reasonable level of risk between the two levels set out in the existing draft; and ii) the Lord Chancellor has power to amend the prescribed assumptions, in regulations to be made by statutory instrument subject to the approval of both Houses of Parliament (the “affirmative procedure”);**

28. The Government agrees with the Committee that policy making should be evidence based.
29. The Government’s evidence shows that the present system is very likely to be producing significant levels of over-compensation relative to the amount of compensation that would, in the setting of the discount rate, be expected to be produced under the 100% compensation principle. This is demonstrated in the research of the Government Actuary’s Department<sup>15</sup> published alongside the draft legislation indicating that average awards may exceed the expected return by about 35%, although after an allowance is made for necessary expenses on tax and investment management, this figure may fall to between 20-25%. That research also confirms that investment in ILGS alone is not without risk. The evidence from consultation indicates that claimants, as a whole, invest in diversified low risk portfolios and do not invest their awards in ILGS alone.
30. The Government accepts that its evidence is not fully comprehensive. The Government has, however, taken extensive steps to gather evidence about the discount rate over an extended period of time through public consultation and research: including the responses to the March 2017 consultation<sup>16</sup> (as well as earlier consultations in 2012 and 2013)<sup>17</sup> and direct engagement with a number of wealth managers through professional associations, who are well placed to provide evidence on the relevant investment behaviour because of their work on behalf of clients subject to the supervision of the Court of Protection. As mentioned,<sup>18</sup> this evidence demonstrates that claimants do not invest as the present law assumes and that they

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<sup>15</sup> Government Actuary’s Department *Ministry of Justice Personal Injury Discount Rate Analysis* <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>

<sup>16</sup> The Personal Injury Discount Rate How should it be set (published September 2017) <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>

<sup>17</sup> Damages Act 1996: The Discount Rate How should it be set (published August 2012); Damages Act 1996: The Discount Rate Review of the Legal Framework (published February 2013) <https://consult.justice.gov.uk/digital-communications/damages-act-1996-the-discount-rate-review-of-the/>

<sup>18</sup> See paragraph 29.



use diversified low risk portfolios. There may be limits to the amount of evidence that it is realistic to expect to be collectable (for example, the holders of the evidence may well be reluctant to provide it to third parties if their expectation is that any change in the rate will be disadvantageous to them). However, the evidence that has come to light is clear and convincing as to the case for change and strongly supports the need for the new framework. The Government has published the information on which it has relied and no evidence to contradict this body of evidence was provided to the Government on consultation. The Government is therefore confident that the evidence provided accurately reflects the real-world investment behaviour of claimants. **The Government accordingly believes that its evidence is sufficient to justify changing the law and does not consider that reform of the law should be delayed pending a further evidence gathering exercise.**

31. This is not to say that the Government believes it now holds all of the evidence necessary for actually completing a review and choosing a specific discount rate. The Government fully recognises that having further evidence of actual investments and of recommended investments (which have to be taken into account in the setting of the rate under the proposals in the draft Bill) is central in the setting of a realistic and fair discount rate and intends to improve its evidence base in time for the first review by calling for evidence and commissioning further analysis. The Government anticipates that evidence gathering exercises will be undertaken in relation to all future reviews.
32. The sufficiency of the Government's evidence base does not of itself rule out the taking of a power as recommended by the Committee to amend the statutory assumptions for the setting of the rate in due course. **The Government considers, however, that such a power would be undesirable in this instance.** It would create uncertainty as to the durability of the proposed assumptions for the setting of the rate, which would disadvantage claimants and defendants who in consultation have stressed the need for certainty.
33. **However, in recognition of the Committee's concerns and in preparation for the first review of the rate under the proposed legislation, the Government commits to seek further evidence to inform the first review. In particular:**
  - a. **the department will issue a further call for evidence to obtain any additional relevant information.**
  - b. **The department will commission the Government Actuary's Department to carry out further research and analysis of the assumptions to be made about inflation, tax and management costs.**
  - c. **The department will also commission the Government Actuary's Department to carry out further analysis along the lines of the report published with the draft legislation but covering a wider range of assumptions (for example, as to the length of awards, the report only considered 30 year awards, while the new analysis could take other durations into account).**
34. The Committee also recommended that:

**If the rate is to take account of investment behaviour, a mechanism must be established to keep those responsible for setting the rate informed about that behaviour. This mechanism must ensure it captures the behaviour of those claimants who do not access professional investment advice and fund management. (para 53).**

35. The Government considers that those involved in each review should be able to gather and consider all evidence they feel is relevant to setting the rate; and that the Lord Chancellor and the expert panel will be best placed to decide what mechanisms for obtaining this evidence are best suited to the circumstances at the time – and in doing so they will be able to draw on experience of earlier reviews. The Government has concerns that specifying a procedure or mechanism that formally required claimants and their advisers to inform a third party of their investment choices could prove intrusive and become expensive, out-dated and burdensome and is therefore not minded to create one at present. **The Government will, however, investigate whether an appropriate and proportionate mechanism could be created to keep those responsible for setting the rate informed about claimants' investment behaviour. The Government notes the Committee's concern that the mechanism should capture the investments chosen by claimants who do not obtain professional advice. The Government will include consideration of this possibility and an assessment of how many claimants are affected in its investigation.** The Government would, however, expect that very few claimants in receipt of large lump sum awards (often worth several millions of pounds) for future financial loss would not obtain professional advice as to how to invest and manage their award.

### Definition of “low risk”

36. The Committee commented that: **“There does not appear to be a consensus about what type of portfolio would be suitable to set a discount rate for claimants. There are likely to be multiple portfolios with differing rates of return that would fit into the Government's requirement of an approach involving (i) more than a very low level of risk, but (ii) less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.”** (para 59); and added that **“We also think that it may be problematic for the Lord Chancellor to use investment behaviour of claimants to set the rate of return within the range. There are no such data widely available, and currently no mechanism in the draft legislation to obtain those data; and also claimants could be taking on more risk because they are being under-compensated.”** (para 60).
37. The Committee then recommended that: **“Until the Government obtains data on whether claimants are being appropriately compensated and not just with regard to investor risk, we recommend that the Lord Chancellor as a starting point sets the rate at the lower end of the range of “low-risk” to avoid the risk of under-compensation for claimants.”** (para 60).
38. The Committee also recommended later in its report in the context of its consideration of social costs that: **“instead of targeting 100% compensation, neither “under” or “over” compensation, the Government should consider adopting as a target the median level of compensation to tend towards over-compensation; or should at least ensure that there are adequate safeguards to**

**prevent significant under-compensation of the most vulnerable claimants.”**  
(para 88)

39. The Government accepts that there is a range of approaches to risk that could be taken within the proposed legal framework. The range between an approach which is less cautious than very low risk but more cautious than the approach a prudent and properly advised ordinary investor would take is broadly intended to represent a “low risk” approach to investment. There may be several different possible portfolios within the permitted range that could be used to inform the setting of the rate. In exercising his or her power under the statutory framework the Lord Chancellor will have to decide the content of the portfolios by reference to which he or she intends to set the rate and where within the range of expected returns the rate should fall.
40. In doing so, the Lord Chancellor, who will have had the benefit of consulting the independent expert panel when he or she comes to make the decision as to what the rate should be, will take into account the evidence of how claimants invest and the investments that are available. The Government accepts that obtaining comprehensive information for any review may not be possible, but does not consider that this should prevent a review taking place or that adequate information to form a reasonable estimate of the returns that claimants can be expected to receive will not be available following a call for evidence for this purpose. As mentioned, the Government accepts that evidence of investments must be analysed in relation to the circumstances influencing the decisions to make the investments.
41. As we have mentioned, the Government does not intend that the Lord Chancellor should target the median level of compensation.<sup>19</sup> The Lord Chancellor’s duty will be to set a rate that satisfies all the requirements of the new legal framework and the provisions relating to the approach to investment must be read in that context. The investment strategy to be assumed in the setting of the rate must therefore be aimed at identifying a diversified portfolio of investments that a properly advised claimant with a low risk approach to investment would make with a view to securing enough money to meet the costs and losses in full when they fall due to be paid. The Lord Chancellor’s assessment of the types of investments that claimants are to be expected to make will be made in the light of evidence as to actual and available investments at the time of the review. **The Government does not consider that it would be appropriate to specify that the rate should be in the lower or any other part of the permitted range.**
42. In choosing to leave the Lord Chancellor a reasonably broad range of discretion as to where in the permitted range the rate should fall, the Government acknowledges the importance of ensuring that the reasons for the Lord Chancellor’s decision are clearly explained. This is discussed in more detail below.<sup>20</sup>
43. **The Government fully shares the concern of the Committee that the setting of the rate should not result in significant under-compensation for the most vulnerable claimants and that there should be adequate safeguards to prevent this.** The statutory discount rate is, however, only one element of the scheme by which compensation is calculated and the factors that may influence the ultimate adequacy of an award of compensation for better or worse are many and varied –

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<sup>19</sup> Para. 18 above.

<sup>20</sup> Para 83

and may arise after the award has been paid. The extent to which the discount rate can ensure full compensation in practice is therefore limited. Within the matters that the rate can influence, the best protection for claimants is that the rate set by the Lord Chancellor with advice from the independent expert panel will be a reasonable estimate of the returns to be expected from the investment of a lump sum award for future financial loss. Such a rate will properly support the objective of the law, which is to provide 100% compensation, neither more nor less.

44. The Government accepts that relative to the amounts of compensation that would have been calculated using the present discount rate law, the awards under the new law will be lower, but seriously injured claimants with long term needs arising from the injury will still receive very substantial amounts of compensation that are expected to meet their needs. The present law is producing awards that are on average too high and the proposed changes will draw the average down closer to the objective of 100%. Overall, this will provide claimants with the money they are expected to need and be fairer to defendants. Precisely where the rate will fall and what the balance between expected under and over compensation for claimants will be are matters to be decided by the Lord Chancellor on the advice of the independent expert panel and HM Treasury, and in the light of the evidence available. **However, by rejecting the possibility of targeting median compensation, the Government has indicated its expectation that a rate set at that level would, at 50% of claimants, produce too high a level of expected under-compensation. The Government therefore believes that its proposals for the setting of the rate will provide a fair rate for claimants and defendants, with sufficient safeguards against significant under-compensation as a result of the setting of the rate, particularly when these proposals are considered alongside the availability of periodical payment orders.**

#### Periodical Payment Orders (“PPOs”)

45. The Committee made a number of comments regarding PPOs.

**PPOs offer a very useful alternative to lump sum awards, when appropriate, and can also be offered in combination with them. They transfer mortality and investment risk to defendants or the NHS, who are better placed to absorb those risks. (para 70).**

**It is not certain whether the low uptake of PPOs is due to claimant or defendant reluctance or a mixture of the two. The enthusiasm of some witnesses, including those representing claimants, for amendment of the Civil Procedure Rules to make it a requirement for PPOs to be offered does not suggest claimants are strongly resistant. We believe that the low uptake means that PPOs cannot be viewed in all cases as a realistic alternative to a lump sum. Evidence that insurers must reserve for PPOs at negative rates means that PPOs are likely to be costly, and presumably less attractive, for insurers. (para 71).**

**It is perhaps telling that insurers must be “cautious” and reserve for PPOs at a significant negative discount rate. Claimants must also be cautious, though for different reasons. We acknowledge that insurers are given no choice, but if a rate based on zero-risk investment is mandated for them, it strengthens the case for that being viewed as an appropriate investment strategy for claimants. (para 72).**

46. PPOs are essentially guaranteed annuities planned to meet the whole or a proportion of the expected future costs and losses caused by the wrongful injury. They are often combined with a lump sum payment. They are available in principle in most cases, although they are not always suitable for claimants.
47. PPOs may be index-linked or variable. Most PPOs are index-linked. A variety of indices are used, including, for example, the Retail Price Index and ASHE 6115. Variable PPOs are far less common. In some the amounts payable can be reassessed in the light of a significant deterioration or improvement in the claimant's condition, if the original order permits this. In others, the amount payable from time to time varies in accordance with the order as originally made (for example, where it is predicted that additional or reduced care will be required at certain times). The latter are much more common.
48. The Government agrees with the Committee that PPOs transfer mortality and investment risk and that they can ensure, in these respects, a lifelong risk-free income for the most vulnerable claimants. The Government therefore sees many benefits in the use of PPOs to provide compensation in respect of future losses and believes that PPOs offer considerable advantages to claimants – particularly those who are most dependent upon the provision of long-term future care. The Government agrees with the Committee that it is not obvious why PPOs are used in relatively small numbers of cases.
49. The Government notes, however, that although several stakeholders commenting on the draft legislation considered that something should be done to make PPOs more attractive, there was no consensus or indeed many suggestions as to what might be done to achieve this. Perhaps even more tellingly, there was little enthusiasm for any changes to the law regarding PPOs in response to the consultation in March 2017, which actively sought suggestions for reform. It is therefore not clear what might be done to increase the take up of PPOs.
50. On the basis of discussions between officials and stakeholders, the Government believes that a reason for the lack of greater take-up, may be that claimants and defendants make assessments of the relative attractiveness of lump sums and PPOs in their negotiations and that this influences the terms of the final settlement. Ultimately, it may well be that claimants find what they perceive as adequate lump sum settlements more attractive than PPOs and that, in view of the cost of reserving for the future liabilities they create, insurers may offer more to achieve a lump sum settlement in preference to a strictly equivalent value PPO. These freedoms respect the autonomy of the parties to reach the settlements that suit them. Many settlements do apparently include both lump sum and PPO elements. It is, however, difficult to say whether the decisions made in deciding how the settlement was to be made were properly informed. Clearly, it would be beneficial if all claimants were properly advised at that stage. **The Government will therefore investigate the quality and effectiveness of the advice currently available on how an award should be taken and will, in any event, provide or endorse guidance on standard practice to ensure that claimants are properly informed as to the implications of choosing between a lump sum and a PPO.**
51. The Government considers that although lump sum awards for future loss and PPOs are alternatives, taking a PPO for all or some of the award may offer considerable advantages to claimants and that it would be advantageous to ensure they are used as often as is practicable. However, in the light of the responses to the consultations,

the Government believes that the best way to improve the use of PPOs within the compensation system is for claimant and defendant interests to identify proposals which would work in practice. **The Government will investigate, either directly or with the help of a third party, whether there are any ways in which the present law and practice regarding PPOs could be improved to ensure that any avoidable obstacles to their use are removed.**

52. **The Government notes the Committee's comments regarding the rates at which insurers reserve for their PPO liabilities. The purpose of the prescribed discount rate, however, is to estimate the return to be expected from the investment of the lump sum rather than to ensure that there are sufficient reserves to meet future liabilities.**

### Quantifying the costs and benefits

53. The Committee stated:

**We believe that the Government should have given an estimate of the costs and benefits of the legislation in its impact assessment, based upon its "assessment" that the discount rate would be between "0% and 1%". This would have given Parliament and stakeholders a far better idea how this legislation will affect claimants in the short term. (para 79).**

54. The impact assessment was intended to assess the overall impact of the proposals relative to the existing legal framework for the setting of the rate. The 0% to 1% estimate was intended to be a helpful indication of the potential scale of the change in the rate, relative to the rate of minus 0.75% set in March 2017, that the new legal framework might produce. The publication of the figure was not intended to represent the actual outcome of a review. Creating estimates of the costs and benefits that would flow from rates in the region of 0% or 1% would be potentially misleading. **The Government does not consider that it would be appropriate to speculate on the outcome of the first review of the rate under the new law.**
55. The Committee also recommended that **"whenever the Government changes the discount rate under this legislation, it publishes at the same time an estimate of the costs and benefits of the change to claimants and defendants."** (para 79).
56. The Government agrees that claimants and defendants should be able to understand the significance of an actual change in the rate. **In response to the Committee's comment the Government confirms that it will prepare impact assessments to accompany secondary legislation every time the rate is changed.**

### Social Costs

57. In relation to the social costs of changing the way the rate is set the Committee commented that:

**When formulating policy for setting the discount rate, we would expect the Government to have given careful consideration to safeguarding the interests of those claimants who could be significantly under-compensated. (para 86).**

58. The Government believes that claimants should receive full and fair compensation and that the setting of the discount rate should play its part in that. The overall objective of setting the discount rate is to estimate fairly and reasonably what the rate of return is to be expected from the investment of a lump sum by claimants. The legal framework for the setting of the rate is intended to ensure that the rate fairly reflects what can reasonably be expected. The purpose of doing this is to ensure that the award of compensation matches the claimant's expected needs. As already discussed, **the Government considers that the framework proposed for the setting of the discount rate, including the introduction of an expert panel, will provide the necessary safeguards to protect the interests of claimants.**<sup>21</sup> **The increased transparency introduced in response to the Committee's recommendations will increase accountability and therefore strengthen these safeguards.**<sup>22</sup>

59. The Committee also commented:

**We do not think there is sufficient evidence for the Government's conclusion that its proposed legislation is a proportionate means of achieving a legitimate aim, so as to justify possible disadvantages to those with protected characteristics. Indeed, without adequate evidence about the protected characteristics of claimants, or the cost to claimants, it is hard to see how the Government can draw any sound conclusion about proportionality. (para 87).**

60. The Government agrees that individuals with protected characteristics<sup>23</sup> must be properly protected in the setting of the discount rate – as indeed all vulnerable individuals should be protected. To this end the Government has given proper consideration to the Public Sector Equality Duty. The Government does not accept that its evidence is inadequate for the purpose of proposing changes to the law on the setting of the discount rate or that the conclusions about proportionality based on the available evidence in the equality statement are incorrect. Information on equalities impacts was sought in consultations in 2011, 2012 and 2017. We specifically asked equalities questions to improve our evidence base and requested new evidence from consultees on each occasion. The responses were taken into account in the preparation of the equalities statement published alongside the draft legislation.<sup>24</sup> The Government accepts that the evidence is limited, but, in the context of the setting of the discount rate, considers the evidence provides an adequate basis for consideration of the equalities impact of the proposals and their proportionality.

61. The Government considers that the proposed reforms do not run contrary to the objective of eliminating unlawful discrimination, harassment, victimisation and other conduct prohibited by the Equality Act 2010 or the objective of advancing equality of

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<sup>21</sup> See Paragraph 44

<sup>22</sup> See Paragraph 83

<sup>23</sup> The "protected characteristics" under the Equality Act 2010 are: race, sex, disability, sexual orientation, religion and belief, age, marriage and civil partnership, gender reassignment, pregnancy and maternity.

<sup>24</sup> <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-web.pdf>

opportunity and fostering good relations between people who share a relevant protected characteristic and those who do not share it.

62. The purpose of setting the discount rate is to help individuals who are unlawfully injured to receive the right amount of compensation so that they can meet all their expected needs as a result of the injury, as closely as practicable. This requires the assessment of an appropriate expected rate of return from investments. This assessment relates to returns on financial instruments and is independent of any of the protected characteristics. The proposed methodology will not result in any claimant being treated less favourably than another because of a protected characteristic. Also, although the court has been reluctant to depart from the prescribed rate under the present law where one of the parties shows that another rate is more appropriate,<sup>25</sup> the power to do so (which the Government intends to retain) may provide a means of addressing in individual cases any perceived risk of disadvantage as a result of the prescribed rate in relation to persons with protected characteristics.
63. Disabled persons and young men may be more highly represented in the population of claimants than in the population at large, but the Government does not think that they are likely to be disadvantaged by the proposed changes, which are intended to produce compensation that will meet their anticipated needs. Awards to persons with protected characteristics will reflect the needs of that person as a result of the injury, some of which may derive from the individual's protected characteristic and be recognised in the award. The Government recognises the need to continue to make reasonable adjustments to ensure access to justice is maintained for claimants with disabilities. There is also provision in the proposals for different rates to be applied to different cases. Should the need arise this power might provide a means of ensuring proper protection for claimants within a specified class, which might be defined by reference to a protected characteristic.
64. The Government's obligation under the Public Sector Equalities Duty is ongoing. If, contrary to the Government's expectation, a difference in treatment results in a particular disadvantage to persons with protected characteristics, the Government will have to consider the issue that has arisen, but in the meantime the Government remains of the view that the proposals are a proportionate way to achieve the legitimate policy aim of setting a rate that will produce full and fair compensation. **The Government will, however, update the equality statement in the light of any new relevant evidence of equalities impacts of these proposals and keep them under review.**

## Social Benefits

65. In discussing the social benefits of the proposed changes to the rate the Committee made the following recommendations in relation to motor insurance premiums and clinical negligence costs.

**We recommend the Government report each time it reviews the discount rate on how changes in the rate impact on motor insurance premiums and the extent to which increases in the rate are reflected in reduced premiums, to use this information as a guide to setting the discount rate in the future. If**

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<sup>25</sup> Damages Act 1996 s 1(2).



changes in the discount rate do not lead to reductions in premiums as forecast by the Government in its impact assessment, it would mean that some of the social benefits of setting the discount rate based on a “low risk” investment rather than a “very low risk” investment had not materialised. The Government would need to take this into consideration when setting the discount rate at later stages. (para 94).

It is not clear to what extent the proposed legislation is motivated by a desire to limit growth in clinical negligence costs and insurance premiums. We think it is reasonable for the Government to take into account the impact of the discount rate on clinical negligence payments and insurance premiums and it should be open about this. (para 101)

It is clear from past Government action (or inaction) in changing the discount rate that setting the discount rate is more than a technical decision: it involves balancing the interests of the claimants with the defendants and also balancing the social costs of increased clinical negligence pay-outs and increased insurance premiums with protecting the interests of vulnerable claimants and reducing their risk of under compensation through interest rate movements. (para 102).

66. **The Government welcomes the opportunity to clarify the extent to which affordable insurance premiums and containing the cost of liability for clinical negligence play a part in the setting of the discount rate.** It is important that insurance is affordable and that awards of damages for clinical negligence fully compensate individuals who are unlawfully injured, but do not impose a greater charge on taxpayers than is required by full and fair compensation. If the discount rate does not realistically represent the return to be expected on investment of lump sum awards for future pecuniary loss, consumers and taxpayers will pay either more or less than they should be paying, depending on the extent and nature of the difference between the then rate and what it ought to be.
67. The costs to health service providers and insurers of awards of damages will clearly be affected by changes in the discount rate because the size of lump sum awards as a result of the adoption of a rate will be affected by the rate chosen. The rate should be fair to defendants and claimants. The Government accepts that the indirect cost to consumers and taxpayers are one reason that significant over-compensation cannot be justified. Changes to these costs will, however, be a consequence of a change in the rate, not a contributing factor to the setting of the rate. **The Government is not proposing that the impact of a change in the rate on clinical negligence payments or insurance premiums should be taken into account in the setting of the rate in the way suggested by the Committee.**
68. The overriding objective of setting the rate remains to support the 100% compensation rule. The Government’s proposals for regular periodic review will prevent long intervals between reviews in the future. This should help to make reviews of the discount rate more predictable as well as providing additional assurance that the rate set is appropriate for the then current circumstances. The rate may of course go up or down under the new framework from time to time.
69. The Government considers that it follows from its approach that the creation of a specific mechanism to measure changes in insurance premiums is unnecessary for the purpose of explaining or justifying a change in the rate. **The Government**

**considers that the impact assessment process should, as far as is practicable, identify costs and benefits of rate changes in relation to motor insurance premiums and clinical negligence costs, but the purpose of the setting of the rate is to help ensure full and fair compensation for injured individuals not to strike a balance between their needs and the willingness of society to pay.**

### Differential discount rates

70. The Committee recommended that:

**We recommend that the legislation require the expert panel and Lord Chancellor expressly to consider whether to set different discount rates for different periods of loss or different heads of damage. In both cases, the benefits need to be balanced by the added complexity it would bring to cases. (para 125).**

**We recommend that when the panel considers this, it looks at the experience of jurisdictions where differential discount rates have been used. (para 125).**

71. **The Government welcomes the Committee's recommendation that the possibility of different rates for different periods and heads of loss should be considered at each review.** Different rates for different cases may provide a way of achieving greater accuracy in estimating likely rates of return, but may be more complex to operate. As the Government stated in the paper publishing the draft legislation, it will continue to be possible to set different rates for different types of cases, including by reference to the length of the award.<sup>26</sup>
72. The Government's view is that both the present law and the proposed legislation are intended to permit different rates to be set for the classes of case mentioned by the Committee and, indeed, other potential classes of case. However, several consultees suggested that the terms of the draft legislation were not sufficiently clear that differential rates could be set for as wide a range of circumstances as the Government proposed. **The Government is therefore amending the legislation to make the scope of the power to set different rates for different cases clearer.**
73. The Government agrees with the Committee that the additional complexity of multiple rates should be a factor for the Lord Chancellor to consider in deciding whether to adopt them, because the facilitation of cost-effective settlements is an important part of the justification for the setting of a prescribed rate. It seems likely that if differential rates are under consideration that the experience of other countries would be taken into account by those involved in the setting of the rate.
74. **Having clarified the extent of the power to set different rates, the Government will, as recommended by the Committee, require that in any review the Lord Chancellor and the expert panel will, in the course of their deliberations on what the rate should be, consider whether the setting of multiple rates would be appropriate. The Government does not however intend to specify when consideration of the experience of other countries should be taken into**

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<sup>26</sup> Cm 9500 Para. 11.

**account as it considers that this is a matter to be left to those involved in the review in question to decide.**

### **Additional stakeholder suggestions for amendments**

75. Stakeholders suggested that the drafting of the legislation should be amended to clarify its intended meaning on a number of points. These included defining in the legislation: when the court can depart from the prescribed rate; what is meant by the setting of “no rate”; the cases to which a new rate will apply; and whether separate assumptions were needed in the case of multiple rates. **The Government notes these concerns and has made a number of amendments to the legislation as a result and will provide further explanation in relation to the others in material accompanying the legislation.** Stakeholders also commented about the assumptions to be made in the setting of the rate. Some wished the power of the Lord Chancellor to make assumptions in addition to those specified in the legislation to be removed, whilst others wanted assumptions to be made about the length of awards and the making of long-term investments. **The Government considers that the power to make further assumptions is necessary to ensure the power is sufficiently flexible to deal with changes in circumstance, and that emphasising the importance of long term investments would be inappropriate when the methodology for the setting of the rate applies irrespective of the length of the award.**

## Who should set the rate?

### Structure and length of Review

76. The Committee recommended that the expert panel should be involved in the first review as well as all subsequent reviews. It stated:

**We also agree with the Law Society that the expert panel should be involved in the first review of the rate. (para 108).**

77. In response to the Committee's recommendation the Government has carefully considered the arguments for and against including an expert panel in the first review. The Government acknowledges the benefits that the involvement of the panel in the first review would bring and will work to ensure that the panel is ready to start work at the earliest opportunity. **The Government accepts the Committee's recommendation that the panel should participate in the first review in the same way as for subsequent reviews.**

### Additional stakeholder comments on time limits in relation to the length of review periods

78. Some stakeholders asked for the time periods specified for the commencement of the first review and the duration of all reviews, including the first, to be reduced. There were also requests that the beginning and conclusion of the review (and any related panel recruitment process) should be formally announced to remove any uncertainty as to when the time periods expire. **The Government agrees that the time periods must be clear and is considering whether any formal indicators should be added, but does not consider that preliminary announcements regarding panel recruitment are necessary. The Government intends to begin the first review promptly after the legislation is enacted but does not consider that the specified periods for the conduct of the reviews can sensibly be reduced.** The Lord Chancellor and the statutory consultees will have difficult issues to consider and require adequate time to do so.

### Roles in the decision-making process

79. The Committee commented that: **"Setting the discount rate has repercussions on the taxpayer through government expenditure and also consumers through its impact on insurance premiums and inflation; therefore we think it is right that the decision to set the discount rate lies with the Lord Chancellor."** (Para 107).
80. **The Government welcomes the Committee's support for the proposal that the decision to set the discount rate should continue to rest with the Lord Chancellor, who should be accountable for that decision.**
81. **The Government also welcomes the Committee's endorsement of the introduction of the expert panel into the process for the setting of the rate.** The Committee stated: **"we are convinced of the merit of an expert panel to assist the Government, with some fine adjustment of the process"** (para 133).

82. The Committee made two further recommendations regarding the role of the Lord Chancellor in the setting of the rate:

**However, we recommend that whenever taking a decision on setting the discount rate, the Lord Chancellor should publish his or her reasons for that decision, the advice provided on the matter by the expert panel, and reasons for not accepting the advice of the panel whenever that occurs. (para 107).**

**We recommend that the Lord Chancellor publishes the basis upon which he or she has decided upon a particular rate out of the range available. (para 60).**

83. The Government agrees that building and retaining trust in the system by which the rate is set is important and that transparency in decision-making can support this objective. **The Government therefore accepts the Committee's recommendation that the Lord Chancellor should provide reasons for his or her decision at the time the rate is set. The Government also accepts the Committee's recommendation that the report of the expert panel should be published at the same time. It will therefore be clear whether (if at all) the Lord Chancellor has departed from the advice of the expert panel.**
84. In relation to the expert panel the Committee recommended "***that the panel is quorate only when 4 out of its 5 members are present***" (para 108), rather than when three members (including the Government Actuary) are present as the Government had proposed. Several stakeholders made similar or related recommendations. **The Government accepts the Committee's recommendation that the quorum should be increased to four.**
85. The Committee also stated "**that in deciding the membership of the panel regard should be had to the need to ensure it reflects the balance of interests concerned and represents a full range of expertise on the subject**" (para 105), but did not make any specific recommendation.
86. The four appointed panel members to serve with the Government Actuary are to have expertise as an actuary, an economist, an investment manager and in consumer affairs as relating to investments. The Government agrees that the composition of the panel is very important. The members must be experts in their fields because the essence of the panel's role is to provide expert advice from each of the fields specified in the legislation as to how the rate should be set in accordance with the legal framework. **The Government believes that the fields of expertise specified are those that will be most useful in formulating the advice to the Lord Chancellor.**
87. Although some or all of the members of the panel are likely to be members of representative organisations, once appointed they will be acting in their expert capacities and will not be representing those organisations. The setting of the rate does not involve the balancing of the interests of claimants in obtaining full compensation on the one hand and the effect on insurance premiums and clinical negligence costs on the other. **The panel is therefore intended to be an expert rather than a representative body.**

### Additional stakeholder comments on the review process

88. Some stakeholders thought that the obligations of the Lord Chancellor to consult the panel and to take account of its advice (and his or her power to depart from that advice); and the obligations of the panel to provide advice should be specified in the legislation. **The Government considers that these matters are adequately clear and does not propose to state them explicitly.** The Lord Chancellor must be able to depart from the advice of the panel if he or she believes that the fulfilment of his or her statutory duties in relation to the setting of the rate require it. There were also some suggestions that the role of the panel should be defined more precisely. The Government agrees that the panel has a very important role in the process of setting the rate. The Government intends that the panel will bring additional expertise into the review process, leading to a better system for the setting of the rate.
89. Some stakeholders queried whether the Government Actuary should have a vote other than as a casting vote. **The Government intends that the Government Actuary will have a full role as a member and Chair of the panel and does not intend to change the legislation in this respect.**
90. Stakeholders were broadly content with the range of expertise proposed for the panel, although some thought that greater specification of the types of expertise or qualifications required would be desirable. Some stakeholders also sought reassurance that panel members would not have conflicts of interest. **The Government intends that panel members will act as independent experts in providing their advice. They will be required to disclose potential conflicts of interest.** The aim of the recruitment process will be to find experts of the kinds required. The Government does not consider that further definition is needed in the legislation.

### Management costs and investment advice and measures of inflation

91. The Committee recommended “**that the expert panel advise the Lord Chancellor on the most appropriate way to take into account advice and management costs and inflation when setting the discount rate .... It should also consider the most appropriate measure of inflation to use, when setting the discount rate.**” (para 131). Some stakeholders made similar proposals.
92. As the Government has already mentioned,<sup>27</sup> the expert panel is intended to be a vital part of the new process for the setting of the rate, bringing new expertise of a high order into the review process. Their advice will be important in determining the rate. **The Government therefore welcomes the Committee’s recommendation that the Lord Chancellor should consult the panel about the allowances to be made for management costs and inflation in the setting of the rate. The Government considers that the panel should also be consulted on the allowance to be made for taxation in the setting of the rate.**
93. The Committee also recommended that: **the panel should consider whether the law should be changed to identify a distinct and separate head of damage based on professional advice.** (para 131).

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<sup>27</sup> Para 77

94. The Government acknowledges that the cost to the claimant of professional advice to manage an investment portfolio on an ongoing basis throughout the duration of the award is currently a matter to be taken into account in the setting of the discount rate. The cost of this ongoing investment advice is to be distinguished from the cost of initial investment advice before the award of damages is made. The Government understands that the cost of this initial advice is generally recovered by the claimant from the defendant at the conclusion of the legal proceedings.
95. The ongoing management advice is taken into account because claimants cannot recover these costs as a separate head of damages. They are therefore a cost that has to be paid by the claimant out of income received from investments before the income can be released for the payment of the costs and losses caused by the injury. Should the courts decide that such costs should be recoverable then they will no longer have an effect on the rate of return to be expected by the claimant. This is appropriate as the question of whether something should be a head of damage is primarily a legal question. This question relating to professional costs could be left to the courts to develop as a matter of caselaw, but it could be taken forward by other means. **The Government therefore welcomes the Committee's recommendation and will consider the issue, either directly or through a third party. The Government does not, however, consider that the panel would be the appropriate body to consider whether the cost of professional advice should be a separate head of damage as it does not have legal expertise.**
96. Part of the advice received during negotiations should enable the claimant to give informed consideration as to whether to take their award as a lump sum or, in whole or in part, as a PPO. As mentioned, the Government intends to assess the availability of proper advice on this issue and its effectiveness as part of steps to assess whether current practice on PPOs could be improved.<sup>28</sup>

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<sup>28</sup> See paragraph 51 above.

## When should the rate be set?

### Frequency of review

97. The Committee considered the question of when reviews should take place but did not reach any conclusion or make any recommendation. The Committee did, however, state that: ***“If the Government is determined to set the rate using a “low-risk” diverse portfolio, a periodic review is required” (para 120) and “there is ample evidence that the rate ought to be reviewed and set regularly” (para 131).***
98. As already explained,<sup>29</sup> the Government intends to set the rate using a “low risk” diversified portfolio. **On this basis, the Government welcomes the Committee’s endorsement of its approach of requiring regular periodic reviews.** This will provide a definite temporal framework for keeping the rate accurate. Intervals of 16 years as occurred under the present law are clearly too long and may well result in significant shifts in the rate, as occurred in March 2017. This is a significant protection for claimants and defendants.
99. In response to the draft legislation and earlier consultations stakeholders expressed a range of opinions as to the best interval between reviews. The Government suggested three years and there appears to be a relatively broad degree of support for this. **The Government has therefore decided to retain the proposed interval of no more than three years set out in the draft legislation.**

### Additional stakeholder comments on the review period

100. Some stakeholders were concerned that the periods for the review are specified by reference to a maximum interval and wished earlier reviews to be restricted to exceptional cases. **The Government does not consider that reviews are likely to be called lightly. It does not consider that the power to call a review should be constrained in the legislation.**

### Timing of the review

101. The Committee recommended that:

**Whether or not the new mechanism for setting the discount rate is introduced, we recommend that the Lord Chancellor should ensure that the timing of changes to the rate takes account of the need to minimise disruption to the finalisation of year-end accounts by insurers and the NHS. (para 117).**

102. The Government appreciates the concerns underlying this recommendation (some stakeholders also raised similar points). However, the Lord Chancellor will be obliged to set a rate at the conclusion of a review. The application of the new rate should not be delayed because of factors extraneous to the setting of the rate.

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<sup>29</sup> Para 8



103. The timing of the review will depend upon the Lord Chancellor's assessment of the need for a review or the expiry of the three-year review period. The ability of the Lord Chancellor to take account of year-end account periods, which differ for different sectors, will be very limited. **Whilst sympathetic to the concerns echoed by the Committee, the Government considers the timing of reviews and the implementation of any change in the rate should be left to the Lord Chancellor of the day.**

## Annex

### List of stakeholders who responded to Ministry of Justice consultation

Ageas and Tesco Underwriting  
Association of British Insurers  
Association of Personal Injury Lawyers  
Berrymans Lace Mawer  
Carpenters  
Forum of Insurance Lawyers  
Institute and Faculty of Actuaries  
International Underwriters Association  
Irwin Mitchell  
Keoghs  
LV=  
Medical Defence Union  
Munich Re  
Nestor  
NFU Mutual  
NHS Resolution  
Royds Withy King  
Christopher Sharp QC  
Tokio Millenium Re  
Zurich Insurance

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