Introduction

1. A lump sum award of damages for future pecuniary loss is intended to compensate the unlawfully 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.

2. The personal injury discount rate is applied in the calculation of the lump sum in order 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 for which it is awarded. 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 discount rate applied is less than the rate of return received, the claimant will receive more than was expected at that time.

3. The Government believes that the assumptions as to how claimants invest which have to be applied when setting the discount rate under the present law are unrealistic and may 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 on businesses and individual consumers through higher insurance premiums. The framework for setting the discount rate therefore needs to be re-calibrated to better achieve the objective of 100% compensation.

What is the current position?

4. A discount rate could, in theory, be calculated for every individual case, but this would cause expense and delay to the affected parties in trying to reach a settlement. To avoid these problems the Damages Act 1996 provides for the Lord Chancellor to set a standard rate to be taken into account by the court in assessing the rate of return to be expected. This rate 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.\(^1\)

5. 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 his or her life. This leads 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 show that claimants tend to invest in low risk diversified portfolios and not in ILGS alone. In March 2017, on the basis of the current law, the then Lord Chancellor set the rate at minus 0.75%.

6. The Government’s evidence shows that the present system regarding the setting of the discount rate is very likely to be producing significant levels of over-compensation relative to the amount of compensation that would be expected to be produced under the 100% compensation principle. This is demonstrated in the research of the Government

\(^1\) [1999] 1 AC 345
Actuary’s Department\(^2\) published alongside draft legislation in September 2017 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%.

**What are the proposed changes?**

The Bill provides for the rate:

- to be set by reference to 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.
- to be reviewed promptly after the legislation comes into force and, thereafter, at least every five years.
- to be set by the Lord Chancellor following consultation, in the case of the first review, with the Government Actuary, and, for subsequent reviews, with an independent expert panel chaired by the Government Actuary and, for all reviews, as at present, HM Treasury.

---

\(^2\) Government Actuary’s Department *Ministry of Justice Personal Injury Discount Rate Analysis*