

Title: Setting the Personal Injury Discount Rate IA No: MoJ012/2017 RPC Reference No: N/A Lead department or agency: Ministry of Justice (MoJ) Other departments or agencies:	Impact Assessment (IA)			
	Date: 13 July 2017			
	Stage: Final			
	Source of intervention: Domestic			
	Type of measure: Primary legislation			
	Contact for enquiries: Paul Hughes Tel: 020 3334 3198			
Summary: Intervention and Options				
RPC Opinion: N/A				

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014 prices)	One-In, Three-Out	Business Impact Target Status
N/A	N/A	N/A	Not in scope	Not in scope

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

Where damages for personal injury take the form of a lump sum, the award is adjusted to reflect the fact that the claimant is able to invest the money before the loss or expense for which it is awarded has actually occurred. This adjustment is the personal injury discount rate (PIDR). In England and Wales the PIDR is currently set by the Lord Chancellor under s1 of the Damages Act 1996 with reference to a three-year average of real gross redemption yields on index linked gilts (ILGS). Based on the results of a public consultation, the Government believes that the present legal framework requires the PIDR to be set using unrealistic assumptions about how claimants invest their awards and that changing the current legal framework to reflect how claimants actually, and are advised to, invest will result in fairer outcomes for claimants and defendants. Reviewing the rate more regularly will also provide a more transparent and predictable framework. Legislation is required to change the legal framework used to set the PIDR.

What are the policy objectives and the intended effects?

The policy objective is to change the methodology governing how the rate is set to reflect better actual claimant investment behaviour and ensure claimants are compensated in full, neither more nor less. The Government believes this will result in a fairer framework for claimants, defendants and wider society. The principles on which the rate is to be set will be specified in the legislation. The proposed legislation will apply in England and Wales. Damages law is devolved in Northern Ireland and Scotland.

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

Option 0: Do nothing. Continue to set the PIDR in accordance with the current legal framework.
Option 1: Change the legal framework under which the PIDR is set, in particular by setting it with reference to an investment strategy with a higher expected return than assumed under the current framework.
Option 2: Specify that the PIDR should be set at least every three years with the Lord Chancellor retaining discretion to set the PIDR within three years if necessary.
Option 3: Set up an expert panel for the Lord Chancellor to consult on the issues to consider in setting the PIDR.
Based on evidence submitted during consultation, the Government intends to implement Options 1-3.

Will the policy be reviewed? It will be reviewed. Review date: 3 to 5 years after royal assent						
Does implementation go beyond minimum EU requirements?			N/A			
Are any of these organisations in scope?			Micro Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A		Non-traded: N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: **Date:**

Summary: Analysis & Evidence

Policy Option 1

Description: Change the legal framework, in particular by setting the PIDR with reference to an investment strategy with a higher expected return than assumed under the current framework.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			
High			
Best Estimate	NQ	NQ	NQ

Description and scale of key monetised costs by 'main affected groups'

None monetised. The proposed legislation will enable the Lord Chancellor, when setting the PIDR, to take into account investment strategies appropriate for personal injury claimants. The rate will not change until the Lord Chancellor conducts the first review under the new framework and so the impact of a rate change has not been quantified.

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

The methodology for setting the PIDR will reflect a low risk diversified investment strategy rather than a very low risk strategy as at present. This change will lead to a higher PIDR because of the associated higher rates of return realised from such investments. This will result in smaller lump sum compensation payments, which will be a cost to claimants, and a wider spread of outcomes (both losers and winners) than at present. Some claimants with a low appetite for risk may face increased costs associated with the volatility of investments or lower returns than implied by the PIDR depending on their investment behaviour.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate	NQ	NQ	NQ

Description and scale of key monetised benefits by 'main affected groups'

None monetised. The proposed legislation will enable the Lord Chancellor, when setting the PIDR, to take into account investment strategies appropriate for personal injury claimants. The rate will not change until the Lord Chancellor conducts the first review under the new framework and so the impact of rate change has not been quantified.

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

Defendants, including public sector bodies (such as NHS Resolution) and insurers, will benefit from lower lump sum payments that result from the PIDR being set using the revised methodology. There will be benefits to wider society in terms of lower insurance premiums if insurance companies respond by reducing premiums and equity if there is a reduction in over-compensation.

Key assumptions/sensitivities/risks

It is assumed that claimants vary in their risk appetite, capacity for loss and investment behaviour. We assume no change in the volume of personal injury cases following a change in the discount rate. It is assumed that there is no change in the costs of reaching a settlement. It is assumed that in an open and competitive market insurance companies will pass on any savings derived from a higher PIDR rate onto consumers in the form of lower insurance premiums. There will be substantial savings to public bodies such as NHS Resolution.

Discount rate

NA

BUSINESS ASSESSMENT (Option 1)

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

Summary: Analysis & Evidence

Policy Option 2

Description: Specify that the PIDR should be set at least every three years with the Lord Chancellor retaining discretion to set the PIDR within three years if necessary.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised costs by 'main affected groups'					
None quantified.					
Other key non-monetised costs by 'main affected groups'					
Should the Lord Chancellor wish to review the rate in advance of the three year interval, any administrative costs involved with monitoring the relevant economic indicators are expected to be negligible. Depending on the direction of any PIDR change, reviews will lead to costs either to claimants or defendants, when compared with keeping an existing rate in force. However, over the long term, any impacts are expected to be cost neutral for both claimants and defendants overall, as gains from one review period may cancel out any losses from another review period.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised benefits by 'main affected groups'					
None quantified.					
Other key non-monetised benefits by 'main affected groups'					
Depending on the frequency and direction of any change in the PIDR, reviews will lead to benefits either to claimants or defendants, when compared with keeping an existing rate in force. However, over the long term, any impacts are expected be cost neutral for both claimants and defendants overall, as gains from one review period may cancel out any losses from another review period.					
Key assumptions/sensitivities/risks					Discount rate
Any impacts of reviewing the PIDR at least once every three years will depend on how far the returns on underlying assets in a low risk diversified portfolio move from those at the previous setting of the rate. The discretion of the Lord Chancellor to review the rate at an interval less than three years will mitigate the risk of a large divergence compared with no change.					NA

BUSINESS ASSESSMENT (Option 2)

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

Summary: Analysis & Evidence

Policy Option 3

Description: Set up an expert panel for the Lord Chancellor to consult on the issues to consider when setting the PIDR.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised costs by 'main affected groups'					
None quantified.					
Other key non-monetised costs by 'main affected groups'					
There would be administrative costs in relation to setting up and maintaining an expert panel. Such costs are assumed to be negligible. Claimants and defendants would not be affected by the institution of a panel.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised benefits by 'main affected groups'					
None quantified.					
Other key non-monetised benefits by 'main affected groups'					
Claimants and defendants will not be directly affected by the establishment of an expert panel although they should benefit indirectly from its expertise when the Lord Chancellor consults it with regarding to the issues he/she should consider when setting the rate.					
Key assumptions/sensitivities/risks					Discount rate
It is assumed that the volume of personal injury claims subject to the discount rate will not change as a result of the institution of a panel.					NA

BUSINESS ASSESSMENT (Option 3)

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

Evidence Base

A. Background

The Personal Injury Discount Rate

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

“...to place the injured party as nearly as possible in the same financial position he or she would have been in but for the accident. The aim is to award such a sum of money as will amount to no more, and at the same time no less, than the net loss...”

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

Issues with the Current Legal Framework

8. As described above, the PIDR is currently set with reference to the return on ILGS. However, evidence gathered during the recent consultation (see below) has shown that this return does not reflect the investments claimants actually make or are advised to make. This gives rise to concerns that the assumption that treating all claimants as very risk averse investors may not always be appropriate. If so, the principles established in *Wells v Wells* would lead to the award of lump sums which would over-compensate such claimants.
9. In addition, claimants will, in many cases, have the option of taking a periodic payment order (PPO) instead of a lump sum. PPOs are orders of the court made under section 2 of the Damages Act 1996

that specify that payments be made by the defendant to the claimant at fixed intervals over a period of time¹. A PPO involves the regular payment of the assessed costs of the injury for the remainder of the claimant's life or the expected duration of the injury (as appropriate) and is, therefore, not subject to the PIDR. Where a PPO is available, claimants have access to an income stream which is not subject to any investment risk.

10. In addition, there is currently no set frequency for how often the PIDR should be reviewed, aside from the power the Lord Chancellor has to conduct a review from time to time. This creates uncertainty and can mean that the PIDR is subject to relatively large movement each time it is set. Establishing rules in relation to the review frequency will provide clarity and increase certainty to all those involved in personal injury claims. It may also provide a more transparent and predictable framework for the PIDR to be set on the basis of a wider range of expert advice than is currently taken.

Consultation

11. Given these concerns, the Government consulted on the legal framework within which the PIDR is set. The consultation commenced on the 30 March and closed on the 11 May 2017 and there were around 135 responses. The bulk of these responses were from individuals and organisations representing claimants (mainly lawyers), defendants (mainly insurers) and other interested groups such as actuaries, legal bodies and financial advisors.

12. As part of the consultation respondents were asked to give their views concerning:

- The appropriate risk appetite to be assumed to apply for personal injury claimants, the makeup of any investment portfolios which they believed would be appropriate for such an investor, and about information they might have about how claimants invest their awards.
- Who should set the PIDR;
- The frequency with which the rate should be reviewed; and
- Whether the current legal framework with regard to PPOs is appropriate.

13. In terms of responses, the largest groups of respondents (51 responses mainly from insurers and their advisors) suggested that claimants be assumed to be 'low risk' investors (i.e., between 'very low risk' and 'ordinary prudent' investors) while 41 responses favoured retaining the *Wells v Wells* assumption of 'very low risk'. Among those who favoured it, a 'low risk' appetite was generally held to be consistent with investing in a 'mixed portfolio' of assets which, in addition to ILGS, might include a wide range of other asset types. Such a portfolio also appeared consistent with evidence on how claimants were advised to invest (virtually no respondents stated that claimants were, or should be, advised to invest solely in ILGS alone) and with how many chose to invest their awards. Respondents favouring this option generally argued that the return on such a portfolio should be calculated net of taxation and investment management expenses.

14. In terms of who should set the rate, 35 responses favoured the use of an expert panel while 17 favoured a co-decision between such a panel and another person. However, 48 responses favoured a minister based on advice received from an expert panel. Of these, the most favoured minister was

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

the Lord Chancellor given that the holder of this office is responsible for the courts and the general law of damages.

15. In terms of when the rate should be set, there was general agreement that the current approach was defective with 94 responses favouring specifying when the rate should be reviewed in legislation compared with 18 respondents who disagreed. However, there was considerable diversity as to whether, if this was to be at fixed dates, at what intervals this should occur (with suggested intervals ranging from 1 year or less to 10 years) or whether changes in the rate be 'triggered' by movements in a specified economic variable. There was general agreement that the frequency would depend on the methodology chosen for setting the rate.
16. The consultation responses suggested that many settlements take the form of both a lump sum and a PPO with the claimant's wishes being paramount in most cases. There was a general agreement among respondents, including those representing claimants and those representing defendants, that the current legal framework concerning PPOs was appropriate and not in need of the potential reforms discussed in the consultation document.
17. In addition to the consultation, the Ministry of Justice commissioned the Government Actuary's Department (GAD) to conduct analysis of the impacts of setting the PIDR using different risk appetites and investment strategies. This analysis involved simulation modelling of various scenarios using portfolios with differing degrees of risk and data on the performance of a range of financial assets. The Ministry of Justice also gathered evidence from independent financial advisors and wealth managers with experience of advising personal injury claimants concerning the types of investment they would recommend in a variety of situations which varied by the nature and duration of the settlement.
18. A full summary of the consultation responses, the other evidence gathered during the consultation period and a full discussion of the Government's preferred options is provided in the consultation response document which is being published alongside this Impact Assessment (IA). Therefore, this IA reviews the evidence gained from the consultation, the GAD analysis and the evidence from wealth managers to assess the effects of the preferred options. This includes the sorts of portfolios the Lord Chancellor might consider when setting the PIDR.
19. This IA only assesses the impacts of changing the current legal framework under which the PIDR is set. Thus, other than making the assumption that any PIDR set under the preferred options is likely to be higher than that set under the current legal framework, it does not offer a quantitative assessment of impacts on claimants and defendants at any particular level of the rate.

B. Rationale and Policy Objectives

20. The conventional economic approach to government intervention is based on efficiency or equity arguments. Governments may consider intervening if there are strong enough failures in the way markets operate, e.g. monopolies overcharging debtors, or if there are strong enough failures in existing government interventions, e.g. outdated regulations generating inefficiencies. In all cases the proposed intervention should avoid generating a further set of disproportionate costs and distortions. Governments may also intervene for reasons of equity (fairness) and for re-distributional reasons (e.g. reallocating resources from one group in society to another).
21. In this case intervention is primarily justified on equity (fairness) grounds: At present the PIDR is set with reference to very low risk investments (ILGS). However, the consultation evidence suggested personal injury claimants are advised and do invest in a wide range of portfolios including those of low risk and medium risk (and none invested in ILGS alone). By adopting an investment strategy that is low or medium risk, claimants are exposing themselves to higher levels of investment risk than assumed under the current legal framework but are, on average, likely to achieve returns considerably higher than the current PIDR; that is, they are likely to be over-compensated, on average. Notwithstanding a greater level of investment risk assumed for the claimant, by setting the

PIDR with reference to a low risk investment portfolio rather than a very low risk one, the level of over compensation is likely to be reduced overall.

22. The preferred options also seek to increase the levels of transparency and predictability in setting the PIDR in future.

C. Affected Stakeholder Groups, Organisations and Sectors

23. The following individuals/sectors are most likely to be affected by the preferred options:

- Claimants in personal injury cases and, in some cases, their personal representatives.
- Defendants in personal injury cases, including public sector bodies such as NHS Resolution (who negotiate settlements on behalf of the NHS in personal injury cases), other businesses, insurers and Medical Defence Organisations.
- Members of the expert panel proposed under Option 3.
- Legal services providers, financial advisers, wealth managers and professional deputies.
- Her Majesty's Courts and Tribunals Service (HMCTS) and the judiciary.
- Government departments, including the Ministry of Justice, and local authorities.
- Wider society, either as individuals and groups with views concerning equity and fairness, and as individuals who currently pay insurance premiums and taxation but also as potential claimants in future personal injury cases.

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

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

26. There is scope for an extended negotiation process if the frequency of review is not set appropriately under Option 2. For example, if the PIDR were only reviewed infrequently, the existing rate may no longer reflect prevailing economic conditions. If this were to occur, and depending on the direction of the divergence, either the claimant or defendant might attempt to delay settlement until a new rate is set which is more favourable to themselves. However, any additional fees a lawyer may claim for the work conducted during an extended negotiation may be offset by the opportunity cost of not taking up other cases. Evidence gathered in the consultation indicated that a three year interval would achieve the appropriate balance of allowing award settlements to be conducted with a degree of certainty without introducing undue incentives for parties to delay settlement in anticipation of a large change in the rate. The possibility of further discretionary reviews reduces this risk further.

27. Professional financial advisors and wealth managers (including the investment arms of insurance and legal service firms), who advise claimants how to invest lump sums or manage the claimant's assets often charge fees related to the amount invested. Any change to the PIDR resulting from a change in the assumed risk tolerance of the claimant is likely to have a financial impact on this group (unless the lump sum awarded is sufficiently large that they consider the claimant could achieve the required return without the need for active portfolio management or advice). Professional deputies

appointed to manage the affairs of claimants lacking mental capacity will be similarly affected. We do not consider these any further because the impacts are qualitatively similar to those on the claimant.

28. Professional financial advisors and wealth managers are regulated by the Financial Conduct Authority and are required to consider their clients' best interests when providing their services. We have not, therefore, considered as likely any perverse incentives among these professionals to advise investing inappropriately (for example by advising investment in high yield, high risk assets solely for the sake of raising fee income) under the principles adopted under Option 1.
29. The courts are unlikely to be affected by any of the options presented here over and above being the decision makers to whom the rate is directed. There may be small additional costs related to training and guidance to judges in applying any new rate, especially if the rate is set more regularly. We assume no change in claim volume and no change in the volume that reach later court stages. To the extent that the latter does change, the additional volume is expected to be negligible in comparison with the court's existing workload.
30. Government administrations such as the Ministry of Justice may be engaged in the decision-making process to a greater or lesser extent than currently. The change is assumed to be handled as business-as-usual work with negligible financial impact. There would be remuneration or at least disbursement costs associated with administering an expert panel considered under Option 3.

D. Description of options considered

31. Following a consideration of the consultation responses, and to meet the policy objectives, the Government has decided to reform the legal framework used for setting the PIDR. While these options are not mutually exclusive and could be implemented either on their own or in combination with one or more of the others, for simplicity we have chosen to assess them as a package.
32. These options are:
 - **Option 0/Do nothing. Continue to set the PIDR in accordance with the current legal framework.**
 - **Option 1: Change the legal framework, in particular by setting the PIDR with reference to an investment strategy with a higher expected return than assumed under the current framework.**
 - **Option 2: Specify that the PIDR should be set at least every three years with the Lord Chancellor retaining discretion to set the PIDR within three years if necessary.**
 - **Option 3: Set up an expert panel for the Lord Chancellor consult on the issues to consider when setting the PIDR**
33. The Government intends to implement Options 1-3 as they best meet the policy objectives.

Option 0: Do nothing

34. Under the 'do nothing' option the principles underpinning the setting of the PIDR would not change: a single PIDR (or split PIDR, if considered appropriate) would continue to be set by the Lord Chancellor under the current legal framework, including the principles from *Wells v. Wells*.
35. Under Option 0, claimants would continue to be on average over-compensated if, as suggested by the consultation responses, they invest and are advised to invest in assets with a higher expected return than a portfolio of 100% ILGS.
36. Under Option 0, the Lord Chancellor would continue to be responsible for setting the PIDR after seeking the views of statutory consultees, HM Treasury and the Government Actuary, without a specified time period for a review.

Option 1: Change the legal framework, in particular by setting the PIDR with reference to an investment strategy with a higher expected return than assumed under the current framework.

37. Under Option 1, the PIDR will be set on the basis that it reasonably reflects, in the Lord Chancellor's opinion, the return which a recipient of damages could be expected to achieve on investing his or her lump sum damages. This investment must be made with the object of meeting the losses and costs expected in full and on time with the award exhausted by the end of the term of the award.
38. Under this option, and based on the evidence submitted as part of the consultation, for the purposes of setting the PIDR, the assumed investment risk profile of personal injury claimants should be 'low risk'. 'Low risk' will be defined as being higher than 'very low risk' (that is essentially the current approach based on *Wells v Wells* and ILGS) but less than the risk expected of an 'ordinary prudent investor'.
39. Although the consultations responses suggested claimants are advised to and are investing in assets with a higher expected return than that of a portfolio of 100% ILGS, it is not entirely clear at present what return a claimant should be expected to pursue. This is because the PIDR and a claimant's investment strategy may influence one another, i.e. the size of a claimant's lump sum (determined by the PIDR) may affect the investment strategy pursued. Nevertheless, even after accounting for this inter-dependency, it is likely that, under this option, the PIDR will be set with reference to an investment strategy with a higher expected return than assumed under the current framework.
40. Under this option, when setting the PIDR, the Lord Chancellor may adopt an approach that seeks to balance the aims of reducing the level of over-compensation with a desire to not lead to significant levels of under-compensation. The value of the PIDR may also need to be adjusted downwards to allow for typical investment management charges and product fees associated with such a portfolio, and tax. These issues are discussed in more detail below.
41. Finally, under this option, the existing legal framework, whereby the Lord Chancellor may set more than one PIDR will be retained. Therefore, under this option, the Lord Chancellor may introduce different PIDRs for different classes of case.

The GAD Analysis

42. In order to understand the impacts of this option, it is necessary to explore further the impact on claimant outcomes from changing the assumed risk profile to be used in setting the PIDR. To do this, the Ministry of Justice commissioned GAD to undertake an analysis of these impacts and a summary of this analysis is published alongside this IA.

43. Several independent financial advisers (IFAs) and wealth managers (WMs) provided in-house scales of investment risk as part of their consultation responses, each attached to explicit portfolios². To understand what such a low risk mixed portfolio might look like, the asset allocations of those portfolios corresponding most closely with the concept of low risk, based on descriptions provided by the IFAs and WMs, were aggregated by the Ministry of Justice to construct a representative low risk portfolio. A second portfolio was produced which was determined by what the MoJ have interpreted as being representative of the highest risk IFAs and WMs say they would recommend or have recommended for personal injury claimants. In what follows, we report the results for the portfolio with the lower level of expected risk ('Portfolio A' in the GAD analysis document).
44. This representative 'low risk' mixed portfolio included a diversified range of asset types, the composition of which is shown in Table 1 below.

Asset Type	LOW RISK PORTFOLIO AVERAGE
UK Equities	13%
Overseas Equities	15%
Fixed Interest Gilts	15%
Index-linked gilts	5%
Corporate Bonds	21%
Cash	10%
Property	4%
Alternatives ³	18%
Total	100%

Note: Sum of each asset class does not equal 100% due to rounding

45. The portfolio in Table 1 is only one illustration of what a 'low risk' portfolio might comprise. It does not prejudice the benchmark investment by reference to which the Lord Chancellor, aided by an expert panel, might choose to set the PIDR when it is next reviewed.
46. For illustration only, the Ministry of Justice asked GAD to consider the investment return and risk profile of this illustrative low risk portfolio. To do this, GAD compared the award value given to the claimant (calculated based on a range of different PIDRs) against the amount required for the claimant to run out of income exactly at the end of the term of his or her award. If the amount awarded in practice is larger than the amount required then the claimant is described as over-compensated and if the amount is less than required then the claimant is described as under-compensated. This comparison is calculated for each scenario, meaning that a distribution of outcomes is derived. 'Risk profile' in this instance refers to the range of potential claimant outcomes with respect to under/over compensation.

² In addition to the portfolios and asset allocations provided directly in response to the consultation, portfolio recommendations were provided by four member firms of the Wealth Management Association offering bespoke investment advice to personal injury claimants. This was in response to a MoJ questionnaire, in relation to three representative personal injury cases, with compensation awards calculated based on three different assumed discount rates. The focus of this analysis was on severe personal injury cases, with all four firms having significant experience in advising on Court of Protection cases.

³ To keep the modelling simple, GAD did not generate returns for all possible asset classes. 'Alternative' investments (such as commodities) are modelled as a 'Fund of Fund Hedge Funds' in the GAD analysis (see A.3, p.28).

47. Returns and risk profiles were considered over a 30-year period, based on investment modelling using an Economic Scenario Generator. For simplicity, the investment strategies included in GAD's modelling are assumed to be 'static' in that the claimant is assumed to rebalance the portfolio each year to maintain the original asset allocation (e.g., in line with Table 1 above for the low risk portfolio)⁴. In practice claimants are likely to change their strategy over time – e.g., to reduce levels of risk to 'bank' periods of good returns, to increase levels of risk to recover from periods of poor returns or to reduce the level of risk as the remaining period of the award reduces. As such the range of outcomes shown in the GAD analysis is likely to be wider than that which claimants might achieve should they adopt these approaches.
48. Under the current legal framework, the PIDR is set with reference to real gross redemption yields on ILGS, returns on which are adjusted in line with movements in the Retail Price Index (RPI). For consistency, the Ministry of Justice asked GAD to conduct their analysis with reference to RPI, therefore the results from their analysis are presented in relation to this measure of inflation.
49. By investing in the portfolio in Table 1, the GAD analysis showed a claimant would be expected to achieve a higher rate of return on their investments when compared with investing in ILGS alone, specifically a real return of just above 1% per annum (before tax and investment charges).
50. Table 2 (below) demonstrates the relationship between different PIDRs and the levels of under and over-compensation associated with the returns from the low-risk portfolio outlined in Table 1. If all scenarios are ranked in order from levels of under compensation to over compensation, the median (or the 50th percentile) means that there is an equal probability that the level of compensation will be above or below this level. Here, an award basis of 'RPI-0.75%' means a rate of -0.75% after inflation has been taken into account, which is the current approach.
51. Table 2 shows that the median over-compensation to claimants investing in the low-risk portfolio under the current approach is expected to be 35%, without accounting for tax or management fees. However, for example, if the PIDR were set at 0% with respect to the RPI and claimants invested in the 'low risk' investment strategy, Table 2 shows that the median over-compensation to claimants adopting this investment strategy is expected to be 21% (ignoring any impacts that adjustment for investment management charges and tax may have). However, there is an 11% chance claimants would be under-compensated by 5% or more, and a 6% chance they would be under-compensated by 10% or more.
52. Table 2 also shows that as the PIDR increases, the median level of over-compensation falls. However, the chance that a claimant would be under-compensated by 5% or more increases.

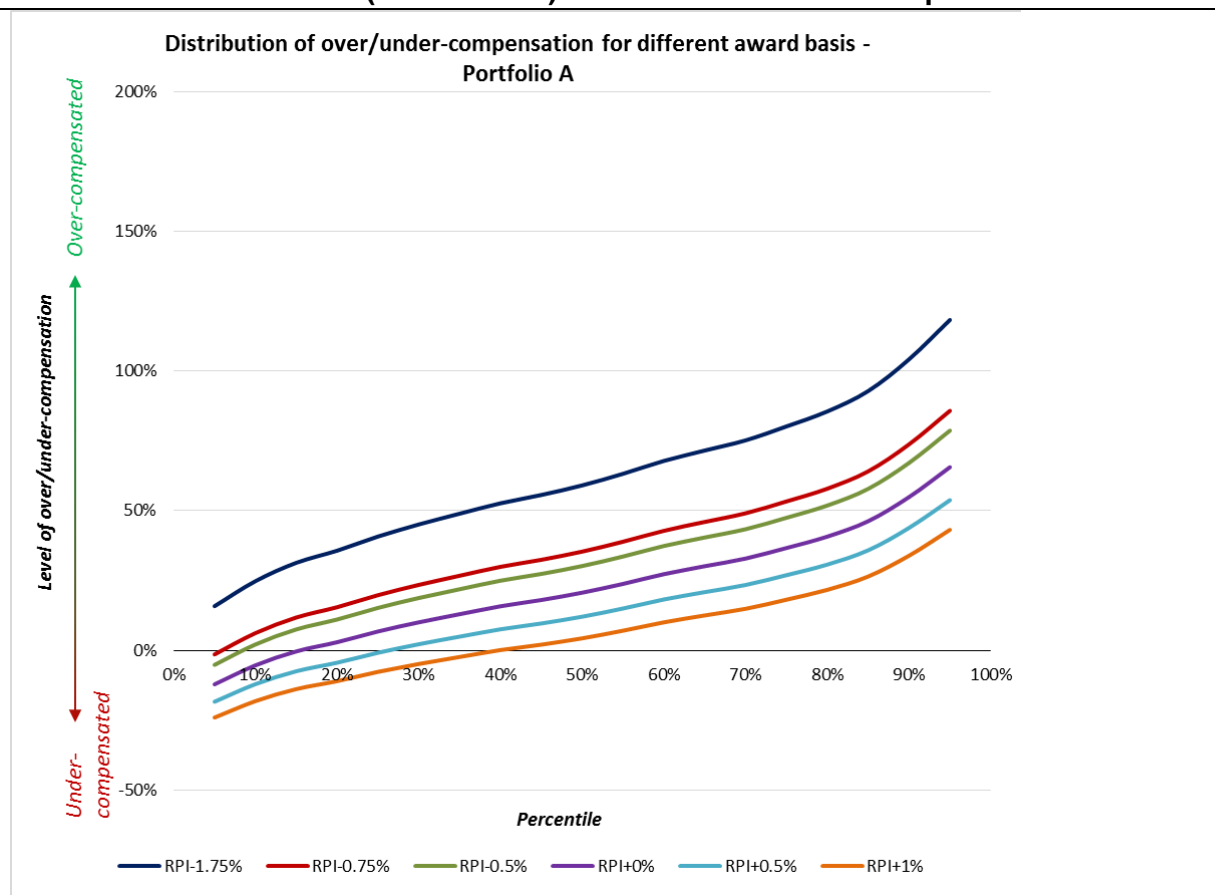
⁴ Apart from the index-linked gilt portfolio, which is assumed to rebalance between index-linked gilts of different maturities to provide a better match to the damage profile – see section 5 and Appendix B of GAD's report for more details.

Table 2: Risk profiles of the low risk portfolio, based on different assumed PIDRs (Award basis) used to calculate the compensation amount						
Award basis	Median level of over-compensation	Tail percentile		Probability of being under-compensated by...		90th percentile
		5th	10th	...5% or more	...10% or more	
RPI-1.75%	59%	16%	25%	1%	0%	104%
RPI-0.75%	35%	-1%	6%	4%	2%	74%
RPI-0.5%	30%	-5%	2%	5%	3%	67%
RPI+0%	21%	-12%	-5%	11%	6%	55%
RPI+0.5%	12%	-18%	-12%	19%	12%	44%
RPI+1%	4%	-24%	-18%	30%	22%	34%

Source: Adapted from Table 11 in GAD (2017).

53. Figure 1 (below) demonstrates the distribution of under/over-compensation, showing the spread of outcomes for each percentile of the distribution diagrammatically. A percentile indicates the value below which a given percentage of scenarios in a group of observations fall. For example, the 5th percentile is the value below which 5% of the observations may be found. Note that 0% on the over/under compensation scale equates with a compensation lump sum being exactly the amount required such that, by investing in the low risk investment strategy, the assumed award profile is met, leaving exactly no money left at the end of the 30-year period.
54. Under the current RPI-0.75% PIDR, Figure 1 shows that there is a c. 5% chance that, if claimants invest in the 'low risk' investment strategy, they would be under-compensated by some amount. This is where the RPI-0.75% curve meets 0% on the under/over-compensation axis. The chances of being over-compensated are c. 95%. Likewise, and based on the example in paragraph 51 above, if the PIDR were set at 0% with respect to RPI and claimants invested in the 'low risk' investment strategy, Figure 1 shows there is a c. 15% chance that they would be under-compensated by some amount and a c. 85% chance of being over-compensated by some amount before any allowance is made of investment management charges.

Figure 1: Distribution of over/under-compensation under low risk portfolio based on different assumed PIDRs (Award basis) used to calculate the compensation amount



Source: GAD (2017), Figure 1

55. Figure 1 shows that, by pursuing an investment strategy which targets a higher expected return than the PIDR, claimants have the possibility of being over-compensated. However, increasing the expected return can also increase the risk of under-compensation, as the range of possible outcomes widens (not shown). Conversely, setting a PIDR lower than expected return reduces the risk of under-compensation. Portfolio A, for example, is expected to return just over RPI+1%, so that discount rates substantially lower than this rate would be expected to result in higher levels of over-compensation.

56. As part of their report, GAD commented on allowances for tax and management expenses. They concluded that although there will be a range of tax implications depending on individual circumstances, the overall the impact of tax is likely to be small. With respect to management expenses, GAD noted that further analysis would need to be undertaken to specifically consider this aspect. But, based on an initial high level assessment, GAD suggested that an annual deduction of around 0.5 percent for both tax and management expenses was likely to be reasonable.

Option 2: Specify that the PIDR should be set at least every three years with the Lord Chancellor retaining discretion to set the PIDR within three years if necessary.

57. Under this option, the Lord Chancellor will be required to review the rate at least every three years. The Lord Chancellor will be required to consult an independent expert panel (Option 3) who must respond within 90 days. The Lord Chancellor will be required to conclude the review and decide whether to change the PIDR as soon as is practically possible and, in any event, within 180 days of

the beginning of the review. If the Lord Chancellor decides to change the rate, he/she will make a statutory instrument subject to a negative resolution procedure.

58. The Lord Chancellor will retain the discretion to trigger an earlier review, if necessary. Any review within the three year period would be at the Lord Chancellor's discretion and there would be no set criteria in place which might 'trigger' such a process. After such a review, the three year period described above would be re-set from the date when the review has been completed.
59. An initial review will begin within 90 days of the revised legislation coming into force. The Lord Chancellor will need to consult the Government Actuary and HM Treasury who will respond within 90 days.

Option 3: Set up an expert panel for the Lord Chancellor to consult on the issues to consider when setting the PIDR

60. Under Option 3, the Lord Chancellor will retain responsibility for setting the PIDR but in doing so will consult with an expert panel and HM Treasury. The panel, whose composition will be determined at each time the rate is reviewed, will be made up of appropriate experts, consisting of the Government Actuary, who will chair the panel, and four other members appointed by the Lord Chancellor on the basis of their individual experience, such that:
- one appointed member has experience as an actuary;
 - one appointed member has experience of managing investments;
 - one appointed member has experience as an economist;
 - one appointed member has experience in consumer matters as relating to investments.
61. The Lord Chancellor will consult the panel in connection with the issues he or she will need to consider when setting the PIDR. In giving its advice, the panel, established for each review, will be required to take into account the duties imposed on the Lord Chancellor in the setting of the rate.
62. The appointments would comply with the Commissioner for Public Appointments Code. The remuneration and expenses of the panel will be met by the Lord Chancellor.

E. Cost and Benefit Analysis

63. This IA identifies *non-monetised* impacts of the proposed policy on individuals and groups in the UK. These impacts are not monetised as this IA only relates to changing the legal framework under which the PIDR is set which does not imply a particular rate. Instead, we consider it important to assess the principles under which the PIDR should be set and for stakeholders to understand the impacts of these, rather than focussing on definitive impacts at different levels the PIDR could be set.
64. The costs and benefits of each policy option are compared with the "do nothing" option. As the 'do nothing' option is compared against itself, the costs and benefits of this option are necessarily zero.
65. In the case of reforms to the legal framework for setting the PIDR, and especially any effects of changing the methodology by how it is set, reform would lead to material changes in the distribution of resources between claimants, defendants and wider society. It is normal practice in IAs to ignore effects which only represent the redistribution of resources between individuals ('transfer payments') and to include in the impacts section only those which relate to the use of real resources. However,

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

Option 1: Change the legal framework, in particular by setting the PIDR with reference to an investment strategy with a higher expected return than assumed under the current framework.

66. Option 1 will lead to a change in the legal framework whereby, amongst other things, claimants will be assumed to be able to bear a higher level of risk. The resulting PIDR will be higher leading to lower lump sum compensation payments as future losses will be more heavily discounted. This will primarily represent a transfer from claimants to defendants including NHS Resolution and insurers. Most of these savings are assumed to be transferred to wider society in the form of lower government spending and insurance premiums.

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

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

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

69. The degree to which a claimant will assume risk in pursuit of a given rate of return, i.e., the claimant's risk tolerance, may be influenced by a number of factors, both intrinsic and circumstantial:

- Two claimants with similar personal characteristics and circumstances could have different attitudes to risk: one may only be willing to invest in ILGS, whereas the other may be willing to invest in riskier assets.
- Claimants who lack the capacity to manage their own affairs will have investment decisions made for them by a representative who may consider it inappropriate to take any more risk than is absolutely necessary.
- Claimants may differ in their circumstances, such as age, life expectancy and injury, which determine capacity for loss. A claimant may not be in a position to take any risk because he or she has particular and expensive care needs and no access to alternative funds

70. Claimants may also need to make provision for the risk that the duration of their injuries or their life expectancies may exceed that assumed when their lump sums were calculated. It should be noted that this 'mortality risk' is already a factor in claimants' investment strategies under the current methodology based on ILGS.

71. A claimant's intrinsic attitude to risk and their provision for mortality risk and other risks are unobservable. As a proxy, a claimant's actual investment behaviour may be used to gauge their preferences for risk. However, it is not possible to draw firm conclusions: the PIDR and a claimant's investment strategy may influence one another, i.e. the size of a claimant's lump sum (determined by the PIDR) could define the investment strategy pursued. Nevertheless, under Option 1 it is assumed that the claimant can bear some risk and therefore a mixed portfolio, containing a range of assets besides ILGS would be appropriate.

72. Mixed portfolios may carry higher investment risks than ILGS alone but also, on average, a higher rate of return, leading to a higher PIDR. The higher risk associated with a mixed portfolio might mean

that some claimants will be worse off if they are unwilling to take risk due to their personal preferences and personal care needs.

Costs of Option 1

73. Under this option, there would be some one-off familiarisation costs for all affected parties. These costs are expected to be negligible.

Claimants

74. A higher PIDR will result in reduced lump sum compensation to claimants relative to Option 0. This would be a cost to claimants and a benefit to defendants, although this is in the context of attempting to reduce overall over-compensation.

75. While GAD's analysis showed that investing solely in ILGS, as assumed in the current legal framework, is not risk free, a higher PIDR may lead some claimants to invest in assets with a higher level of investment risk than they otherwise would have chosen, to ensure that their lump sum awards meet their requirements. Claimants who have risk appetites lower than that implied by the new legal framework may choose to invest in riskier assets than their appetites imply, as a result of a change in the PIDR. Such claimants will also be affected by higher costs associated with greater volatility if investment risks materialise. Some of these risks are outlined below.

76. The capital investment could be more volatile relative to the value of liabilities due to the inclusion in the portfolio of riskier assets such as equities. There could also be a higher level of credit risk on the capital value associated with companies defaulting and, if some proportion of the investment is held in non-Sterling investments, there could be a risk arising from exchange rate fluctuations. Finally, although equities offer some protection against inflation, they are not index-linked, unlike ILGS.

77. Furthermore, fluctuations in capital values might lead the claimant to get a low price for the asset when they are sold to meet the claimant's ongoing costs and deplete the award of damages more quickly than planned. This may prompt the claimant to increase risk in their investments in order to recoup the losses, which could lead to further losses. There may also be tax implications and transaction costs as a result of being forced to sell investments earlier than expected.

78. These claimants may also face additional costs associated with managing their investments although legislation will make allowance for investment management fees when setting the PIDR if the Lord Chancellor considers it appropriate.

79. Alternatively, if claimants with lower risk tolerances are unwilling to invest in the types of assets used to set the PIDR they may invest in less risky assets with lower average rates of return. If so, they risk not fully achieving the streams of income assumed in their settlements and running out of money before the expected terms of their awards. In the event a claimant runs out of money, they would become solely reliant on the NHS and state benefits, with associated costs to the taxpayer.

80. If measures were in place to mitigate the impacts on this group of claimants in the form of a PIDR varying by the term of loss, size of award, heads of claim or varying by some other factor, the impact on this group may be reduced. However, introducing varied rates according to a certain factor may create perverse incentives for claimants. For example, it could encourage claimants to change their claim according to that factor so that their claim would fall under the most favourable PIDR.

81. Claimants who have a risk appetite equal to or greater than that implied by the PIDR set under the new legal framework are assumed to continue to invest in assets which are consistent with their risk appetite and are also assumed to be unaffected by any additional costs from investment risk or

management costs. That said, if a higher PIDR were used to calculate the compensation lump sum owed, this would result in a lower award, which may in turn affect their investment choices.

Defendants

82. Any change in the costs to claimants of managing lump sums might ultimately be passed to defendants as part of negotiating the final settlement.
83. A higher PIDR will make PPOs relatively more attractive to claimants who are unwilling to invest in higher risk portfolios. Insurers, on the other hand, must hold additional capital for PPOs to meet solvency requirements under Solvency II. An increased propensity for PPOs at a high PIDR would, therefore, represent an immediate cost to insurers, albeit one that is likely to be offset by the reduced or absent lump sum in cases settling by a PPO rather than by a lump sum alone
84. NHS Resolution does not have to meet Solvency II requirements so would not be affected in the same way as insurers.

Wider Society including Taxpayers and Insurance Policy Holders

85. Society will suffer a cost if claimants who, as a result of a higher level of investment risk, do not achieve the assumed return on their investments. There are potential greater risks than at present relating to the principle that claimants should be expected to take on risk and may, in some instances, suffer the stress of running out of money and becoming solely dependent on the state.

Benefits of Option 1

Claimants

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

Defendants

87. A higher PIDR is expected to result in reduced lump sum compensation awards by defendants relative to the base case. Defendants would include insurers, government bodies such as the NHS and uninsured businesses and individuals. In the case of insurers it is expected that these benefits will be passed on to consumers in the form of lower insurance premiums relative to the base case.
88. NHS Resolution may benefit in the short term from an increased uptake of PPOs as it would mean lower immediate payments in the cases settling with a PPO rather than a lump sum alone, although total future liabilities would increase.

Wider Society including Taxpayers and Insurance Policy Holders

89. Society will benefit from greater equity (fairness) as the current legal framework is resulting in the over-compensation of personal injury claimants.
90. Individuals and businesses in wider society may also benefit from lower insurance premiums if insurers face lower costs. Such businesses and individuals will also be potential defendants. This would be an indirect impact of this proposal. Taxpayers would benefit in the form of lower government spending on compensation payments in clinical negligence cases.

Option 2: Specify that the PIDR should be set at least every three years with the Lord Chancellor retaining discretion to set the PIDR within three years if necessary

91. The PIDR should reflect the returns on the investments by reference to which the rate is to be set. In principle, subject to avoiding over-frequent changes, it should, therefore, be reviewed as often as is necessary to reflect material changes in expected returns from those investments. However, the

PIDR at any point in time will be an approximation of the underlying investment return and will result in claimants and defendants being either advantaged or disadvantaged. The degree to which this happens will depend on whether the PIDR is either higher or lower than the rate of return implied by the underlying investment portfolio at the point of settlement.

92. As noted above, the consultation responses contained a wide range of views concerning the timing of any review of the PIDR. In addition, any formal review of the rate will be likely to generate some degree of speculation beforehand with regards to its outcome and this may lead to strategic behaviour by claimants and defendants in cases which are yet to settle which may generate additional costs. However, having considered the responses to the consultation, the Government has decided that a three year review period is one which best meets the overall policy objectives.
93. In addition to the requirement to review the PIDR at least once every three years, the Lord Chancellor will retain the power to review the PIDR within such periods with the three year period being reset at the end of such a review. If the Lord Chancellor were to choose to exercise his or her discretion by raising the PIDR in situations where the expected yields from a low risk portfolio are increasing and reducing it when they are falling any divergence between the PIDR and the investment returns achieved by claimants would be reduced, reducing the risk of over or under-compensation.

Impacts of Option 2

Claimants and Defendants

94. Assuming the expected real returns on a low risk mixed portfolio are equally likely to rise or fall over any given period going forward, reviewing the PIDR at least every three years will be cost neutral with respect to expected compensation in the long run, as gains from one review period may cancel out any losses from another review period.
95. In the short term, the length of the review interval may have equity impacts as it may affect the magnitude of any settlements received by claimants with similar types of injury. This is because, if expected investment returns are increasing, claimants who settle within the review period would be treated equally, but those who settle just before a review could receive a different amount of compensation to those who settle just afterwards. There will be an associated effect on defendants.
96. Nevertheless, both claimants and defendants will benefit from greater certainty in the timing of any review of the PIDR in comparison to the base case and any inequities related to timing are likely to be small at a review interval of three years. This conclusion is strengthened if it is assumed that the Lord Chancellor will exercise his or her discretion in reviewing the PIDR at shorter intervals than three years should the rate of return on a low risk mixed portfolio be found to be diverging from those assumed in the PIDR.
97. There may also be behavioural impacts that result from reviewing the rate at least once every three years. For example, in situations where the expected returns on a portfolio are falling, claimants may be incentivised to delay settling a claim in the expectation that a review of the rate would mean they receive a larger lump sum. Equally, in situations where the expected returns on a portfolio are increasing, defendants may be incentivised to delay settling, in the expectation that a review of the

rate would mean their costs are lower. We regard these incentives to be modest under a three year interval.

Option 3: Set up an expert panel for the Lord Chancellor to consult on the issues to consider when setting the PIDR.

Costs of Option 3

Expert Panel Members

98. Members of the expert panel will be remunerated for their time. While remuneration would benefit them individually, their number would be so small as to be negligible with respect to the impacts on claimants and defendants of the decisions they make.

Claimants and defendants

99. Claimants and defendants will not be directly affected by the establishment of an expert panel although they should benefit indirectly from its expertise when the Lord Chancellor consults it with regarding to the issues he/she should consider when setting the rate.

Ministry of Justice

100. There will be a cost of setting up an expert panel each time a review is undertaken which would include recruiting experts and agreeing terms of reference. It is likely that there would be an ongoing

cost of salaries and expenses of panel members each time the panel is established to review the rate. Additional costs may arise if multiple panels are established to review more than one PIDR.

Third parties commissioned by the panel

101. It is possible that the panel may commission third parties to provide investment data or analysis for informing the Lord Chancellor's decision on what the PIDR should be. The costs of ongoing administration would depend on the mechanism for setting the rate.

Benefits of Option 3

Ministry of Justice

102. The Ministry of Justice will benefit from the independence of using a panel of experts when setting the PIDR.

F. Assumptions and Risks

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

- We assume the volume of personal injury claims subject to the PIDR will not change under any of the options considered. Claims for which future pecuniary loss is relevant are made regardless of the value of the lump sum expected.
- We assume the volume of claims reaching the latter court stages is constant. The courts are not affected materially by any of the options presented.
- We assume a change in the legal framework under Option 1 will lead to an increase in the PIDR with respect to Option 0.
- The benefits to wider society under Option 1 in terms of lower insurance premiums is based on the assumption that insurance companies pass their savings from paying out lower lump sums onto consumers.
- There is a risk that some claimants may be unwilling to assume more risk, even if the principles adopted would allow a prudent investor in their situation to bear the assumed risk. Where this happens, the return would not match the PIDR and the individual would run out of money before the expected term of the award. This would lead to more individuals relying solely on the NHS and on other government transfers at the end of their awards with associated costs to the tax payer.
- An increase in the PIDR may make PPOs more attractive to claimants, which would mean some defendants face higher costs. This is offset, however, by the reduced lump sums they would pay in other cases.
- There is risk that claimants or defendants may be affected abruptly by changes to the rate or that they may seek to delay settlement if they anticipate a pending review will produce a rate advantageous to themselves. We regard these risks to be modest under a three year interval. The risks are further mitigated by the discretion of the Lord Chancellor to review the rate at an interval less than three year, if deemed appropriate.

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

104. The change to the way that the PIDR is set under Options 1 and 2 do not qualify as regulatory provisions and do not meet this definition under s22 of the Small Business, Enterprise and

Employment Act (2015). Accordingly, Options 1 and 2 would have no direct impact on business for the purposes of the BIT.

105. With regard to s22(3)(a), which defines a regulatory provision in relation to a business activity as one which 'imposes or amends requirements, restrictions or conditions, or sets or amends standards or gives or amends guidance in relation to the activity'; the guidance the Lord Chancellor is amending solely relates to the court's role in awarding damages and is not guidance on how to carry out a business activity. While the application of the guidance by courts may have knock-on consequences for business (e.g. lower lump sum settlements for insurers or lower insurance premiums for businesses) this does not mean the Government is giving guidance on business activities.
106. With regard to s22(3)(b), which also defines a regulatory provision as one 'relating to the securing of compliance with, or the enforcement of, requirements, restrictions', etc., while the damages that a court awards in a personal injury case might have an indirect effect on business compliance, the court's role in awarding damages is about compensating the victim rather than ensuring any future regulatory compliance.
107. Establishing the expert panel under Option 3 will also be out of scope of the BIT.

H. Wider impacts

108. We have identified that the policy options outlines above may have equality impacts and have set these out in the equalities impact assessment.

Small and micro business assessment (SaMBA).

109. We have carried out a competition assessment and do not anticipate that the choice of the parameters for setting the PIDR will have any competition impact. Any effect will be indirect. The choice of parameters and the rate will apply to all businesses irrespective of their size as any business found liable for a personal injury must pay damages to the claimant.
110. We do not consider that the choice of parameters will affect the operations or performance of small firms or affect them differently from other businesses. This is because the PIDR is applied by the court to its quantification of an established legal liability in personal injury cases, irrespective of the identity of the defendant.

Annex A: Types of investment risk

There are different types of risk to be considered when investing in a portfolio. The table below summarises various types of investment risk (but is not an exhaustive list), noting that the types of risks claimants will be exposed to will vary according to their characteristics and circumstances:

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

The following are measures of some of these risks.

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