Discount rate: statement placed by The Rt Hon Elizabeth Truss MP, Lord Chancellor, in the libraries of the Houses of Parliament on 27 February 2017

1. As Lord Chancellor, I have power pursuant to section 1 of the Damages Act 1996 from time to time to set the discount rate applied to personal injury awards covering future pecuniary losses. In November 2010 my predecessors began a review of the discount rate for personal injury damages awards. On 27 January this year I indicated my intention to complete the review in February 2017.

2. In the course of my review, I have considered all the material available to me, including the responses to a Ministry of Justice public consultation in 2012, the report of an expert panel in 2015 (which reached majority and minority conclusions) and the responses of statutory consultees, HM Treasury and the Government Actuary. The process of review has been lengthy, and extraordinarily thorough. That process reflects the complexity and importance of the subject matter.

3. This statement sets out the decision I have reached as a result of this exercise and a summary of my reasons for that decision. I am also separately publishing today the Response to the 2012 public consultation.

Decision

4. I have concluded that a discount rate of minus 0.75% is the appropriate rate.

Reasons

5. I emphasise at the outset that the approach to the exercise of setting the discount rate is inevitably relatively broad brush. It is not a simple arithmetical exercise leading to a single, correct answer. It involves making judgements at various stages of the consideration of the issues, some of which are finely balanced and some of which involve making predictions about the future which are inherently uncertain.

6. I have noted the object of the award of damages set out by the House of Lords in *Wells v Wells* [1999] 1 AC 34, per Lord Hope of Craighead (page 390A-B):

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

7. I have approached the setting of the discount rate on the basis that the governing principle is as identified by Lord Hope in that case: "*[The discount rate] is the rate of interest to be expected where the investment is without risk, there being no question about the availability of the money when the investor requires repayment of the capital and there being no question of loss due to inflation*."

8. The principles in *Wells v Wells* lead me to base the discount rate on the investment portfolio that offers the least risk to investors in protecting an award of damages against inflation and

against market risk. I take the view that a portfolio that contains 100% index-linked gilts (ILGs) best meets this criterion at the current time. A portfolio of ILGs, comprising stocks spread across a range of redemption dates guarantees the investor an inflation-adjusted income, known with certainty at the time of the award. Basing the discount rate on the real redemption yield of ILGs is consistent with the approach taken by the House of Lords in *Wells v Wells* and by the then Lord Chancellor, Lord Irvine, when he last set the rate in the Damages (Personal Injury) Order 2001 (S.I. 2001/2301).

9. I am aware that issues have been raised as to whether ILGs (or a portfolio containing 100% ILGs) continues to represent a realistic or the appropriate basis for arriving at the discount rate, in part because changed economic circumstances have had an impact on the demand for ILGs. In particular, the case has been made by a number of respondents to the consultation exercises that it might be more appropriate and realistic to use a 'mixed portfolio' approach (in which other securities feature). I acknowledge that those arguments have some merit. However, I am not persuaded by them. I consider that a faithful application of the principles in *Wells v Wells* leads to the 100% ILGs approach as the best way, in the current markets, of ensuring that there is "*no question about the availability of the money when the investor requires repayment of the capital and there being no question of loss due to inflation.*" The mixed portfolio approach in contrast runs counter to these principles by requiring the assumption by the investor of a greater degree of risk.

10. I have specifically considered whether the 100% ILGs approach might create different risks such as the risk of not being able to meet unexpected capital needs. I recognise that point. However, I consider that those risks should be capable of effective management and that they are outweighed by the risks associated with the 'mixed portfolio' approach.

11. In a statement laid before Parliament on 27 July 2001, Lord Irvine recommended that the approach to setting the discount rate should respect the following general principles, which I have adopted.

    a. There should be a single, fixed rate to cover all cases. This accords with the solution adopted by the House of Lords in *Wells v Wells*. It eliminates argument about the applicable rate at court and avoids the complexity and extra costs that a formula would entail.

    b. The rate should be one which is easy for all parties and their lawyers to apply in practice and which reflects the fact that the rate is bound to be applied in a range of different circumstances over a period of time. Given the uncertainties and imprecisions involved in the process of setting the discount rate, a rounded rate is preferable. Accordingly, I have decided to round to the nearest 0.25%. Ogden tables, applied by the courts to adjust awards according to a given discount rate, are currently published for rates at intervals of 0.5%. However, they can readily and swiftly be adapted to an intermediate rate.

12. In his 2001 decision, Lord Irvine obtained a discount rate by taking the average gross real redemption yields on ILGs across all maturity dates. He averaged real yield over the previous three years and rounded after making allowances for various factors. Lord Irvine noted that Lord Hope in *Wells v Wells* had regard to an average of gross redemption yields on ILGs with more than five years to maturity. Lord Irvine decided, however, to include all stocks in his calculations on the basis that some claimants, whose losses extend over periods of about 5 years or less,

would have to purchase all or most of their ILGs in this category of stock. However, real yields on ILGs vary according to the maturity dates of stocks. I consider that it is the real yields of long-dated stocks that should be given more weighting when setting the discount rate according to real ILGs yields. This is because awards intended to cover the longest periods are most sensitive to any discrepancy between the discount rate set and the real yield obtained at the date of the award. Indeed, many awards are for the long term, quite often decades.

13. To weight long term stocks in a simple and transparent way, I have taken a simple average of gross real redemption yields across all ILGs and, in line with *Wells v Wells*, have excluded stocks with less than five years to maturity. This is not to deny the need for some or, indeed, all claimants to receive an income in the first few years of their award but to account, in a simple way, for the effect that short-dated stocks can have on real redemption yield as a representative discount rate for claimants as a whole. The real yield data on which I have obtained an average are those published by the Debt Management Office (DMO).

14. Regarding the period over which the real redemption yield is averaged, I have followed the majority view from *Wells v Wells* and the practice adopted by Lord Irvine in 2001, namely to average over the three years to a convenient date (in this instance, 30 December, the last trading day of 2016). I note that real yields have witnessed steady decline since 2001 and there may be a case for changing the averaging period to limit the influence of historical trends. However, I am reluctant to depart from earlier practice on this occasion.

15. The three year simple average gross real redemption yield on ILGs is minus 0.83% as of 30 December 2016 excluding ILGs with less than 5 years to maturity. As noted above, it would be appropriate to round this figure to acknowledge the inherent uncertainties and imprecisions involved in setting a representative discount rate and I am persuaded that rounding to the nearest 0.25% points is adequate. This would lead to a discount rate of minus 0.75%. The only reason to round down to minus 1.00% would be to account for claimant costs, in particular taxation and management fees. However, the case for such adjustment is not strong and has weakened in recent years. Because of the steady issuance of new ILGs with lower coupons (and, therefore lower taxation), it is not unreasonable that an adjustment for tax should be lower now than when Lord Irvine determined the discount rate in 2001; and investment management costs are relatively modest for ILGs.

16. For all of these reasons, I have decided that the discount rate should be minus 0.75%.

The Rt Hon Elizabeth Truss MP

Lord Chancellor

27 February 2017