Ministry of Justice

Setting the Personal Injury Discount Rate

Summary of Responses to the Call for Evidence

This response is published on 15 July 2019

Protecting and advancing the principles of justice

Contents

Introduction and contact details

This document is the summary of responses to the paper '*Setting the Personal Injury Discount Rate: A Call for Evidence*'.

It will cover:

- the background to the report
- a summary of the responses to the report
- a detailed response to the specific questions raised in the report
- the next steps following this Call for Evidence.

Further copies of this report and the Call for Evidence can be obtained by contacting the address below:

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Email: discountrate.evidence2018@justice.gov.uk

This report is also available at https://consult.justice.gov.uk/

Alternative format versions of this publication can be requested from discountrate.evidence2018@justice.gov.uk.

Complaints or comments

If you have any complaints or comments about the Call for Evidence process you should contact the Ministry of Justice at the above address.

Background

The Lord Chancellor, in the first review, is responsible for setting the discount rate, which is used to determine lump sum damages awards to claimants who suffer a serious personal injury.

The methodology for the process of setting the rate was amended by the Civil Liability Act 2018, and to help inform the process for the first review conducted under the new legislative framework, the Ministry of Justice issued a Call for Evidence in December 2018.

Evidence on the following issues was sought in the Call to inform the setting of the discount rate:

- Investments available to claimants;
- Investment advice provided to claimants;
- Taxation;
- Inflation;
- Investment management costs;
- Model investment portfolios; and
- Other considerations that should be taken into account in this process.

'*Setting the Personal Injury Discount Rate: A Call for Evidence*' was published on 6 December 2018. The Call for Evidence period closed on 30 January 2019. This report summarises the responses received. The Ministry is grateful to all those organisations and individuals who have shared their expertise and experience in their submissions.

An Impact Assessment was not published with the Call for Evidence. In response to the commitment made in '*Personal Injury Discount Rate: Response to the Report of the Justice Select Committee'* we will prepare an impact assessment to accompany the secondary legislation when the rate is changed.

A Welsh language summary can be found on gov.uk.

A list of respondents is at Annex A.

Summary of responses

1. A total of 40 responses were received to the consultation paper. Of these, 13 were from the insurance industry, 14 from the legal profession lawyers), six from financial advisers, three from the health sector, and four from other experts).
2. The following section sets out a summary of the very detailed material provided and answers given to the individual questions posed. The Ministry is very grateful to respondents for the material and data submitted. In addition to detailed responses on the individual questions, some extremely useful material was submitted; including:
    1. commentary on the principles and methodology;
    2. general comments on the use of Periodical Payment Orders (PPOs);
    3. evidence of anonymised individual claimant profiles;
    4. evidence of actual (anonymised) portfolio composition and performance;
    5. commissioned reports on various aspects e.g. analysis of investment market conditions, general future economic outlook.
3. The exercise was particularly helpful in the context of allowing respondents to submit data and material that reflected the new methodology for setting the personal injury discount rate, which the Civil Liability Act 2018 introduced for setting the rate.
4. The views and material submitted often reflected the competing interests and differing perspectives of those representing claimants and defendants. They helped illustrate the complexity of the discount rate setting process, in terms of the multiplicity of factors and economic variables which are at play and must be taken into account.
5. The Call for Evidence has directly informed the advice which the Government Actuary will be providing the Lord Chancellor on setting the rate, and the advice he has received from the Ministry's officials.

Responses to specific questions

Q1:

(a) What asset classes are generally available to claimants investing lump sum damages and suitable for the hypothetical "low-risk" investor envisaged in the setting of the discount rate?

(b) What asset classes are not generally available in practice to such an investor, for example due to reasons of scale, liquidity, cost-efficiency or unsuitability?

This question sought evidence and views on the asset classes available to investors in practice, and in particular to personal injury claimant investors, and those not generally accessible to that group of investors.

Of the 40 responses, 21 directly answered the question in some capacity. Most of the responses were from insurers and financial advisers. The general consensus was that the majority of asset classes are available to most private or corporate investors, if a claimant used an independent financial adviser.

However, it was suggested that some of the asset classes would be unlikely to be directly available to claimants as investments - gilts were commonly mentioned under this category - but that they could form part of a portfolio through a trust or fund.

Some respondents, including the Institute and Faculty of Actuaries however were less convinced that index-linked gilts are impractical for direct investment. Their view was that a range of gilts are available for purchase and sale by the general public, either on the internet or by post, subject to passing the money laundering tests of the Debt Management Office.

The available asset classes include:

- Cash
- Bonds – Gilts, corporate and other
- Equities – UK and overseas
- Property
- Commodities
- Collective investments including Open-Ended Investment Companies and Investment Trusts, Exchange Traded Funds (ETF)
- Derivatives
- Hedge funds
- Alternative assets (e.g. infrastructure or renewable energy);

In terms of <u>suitability</u> there were mixed views from respondents generally, and this was also the case when looking only at responses from the finance sector. Some felt that all the asset classes listed above would be suitable for the hypothetical low risk investor, and it was the amount allocated to each which would determine suitability for this investor type.

Other respondents pointed towards only the lowest risk asset classes being suitable for this type of investor, and those cited included. cash, certain equities such as large capitalisation or index tracker/Index linked stock, UK, Corporate and other bonds (high quality only) and structured deposits.

In contrast the assets deemed as unsuitable were generally investment/commercial property, private/individual equity, commodities, hedge funds, infrastructure, structured products, derivatives, complex types of ETF and high yield bonds. This was in part due to the complexity of this form of investment for a typical claimant investor.

A number of respondents from a claimant perspective said that only a few basic asset classes were appropriate e.g. bonds, gilts, equities in terms of the level of risk that should be borne. Insurer respondents tended to be less cautious, as long as claimants were taking appropriate advice.

Respondents also mentioned that in order directly to purchase bonds or fixed interest assets there may be a minimum investment sum requirement, which could alter the asset allocation of an investor's overall portfolio, rendering it unsuitable for their needs.

Q2:

(a) Please provide information regarding how recipients of lump sum damages awards for future financial loss are typically advised to invest, when they are normally advised and why?

29 respondents addressed this question in some form, with responses from across the different stakeholder groups. The responses can be summarised as follows.

The general view was that the financial advice claimants receive can broadly be split into two types:

(i) The first is pre-settlement advice from an expert witness. This covers advice on the suitability of the type of settlement to be pursued in that individual claim, either lump sum, or Periodical Payment Order (PPO). It does not cover advice on how the claimant may invest any sum of damages. The cost of pre-settlement advice of this nature is usually in the region of a few thousand pounds depending on the complexity of the claim. This advice can be recovered as a disbursement.

(ii) The second type of advice is provided after the award is made, so following settlement or trial. This secondary advice relates to investment strategies. This is not recoverable from the defendant so is borne by the claimant out of their award. The cost to the claimant will depend on what their financial needs are, which in turn follows the complexity of their circumstances and future care needs.

There were two broad reasons given for this advice being post-settlement. Firstly, professional ethics and the duties of an expert under Part 35 of the Civil Procedure Rules preclude the provision of advice on the investment of a lump sum award at an earlier stage – for instance because advice could run the risk of creating an expectation on the claimant's behalf that may not be realised by the damages (if any) they ultimately recover. Secondly, investment strategies would only be reliable once there is certainty as to the amount of money available for investment. This can be delayed whilst costs are resolved (one respondent suggested this typically takes 6-18 months). Following this the claimant can make informed decisions concerning capital expenditure such as property purchase and adaptation (estimated to take a further 12-24 months). Therefore, it may be a number of years following settlement of the claim before the claimant can make long term investment decisions. We received little evidence on the cost of this advice.

In terms of how claimants are advised, those able to respond generally outlined a similar process which involves understanding the client's personal and financial circumstances – such as life expectancy, initial capital outlay, risk appetite - before investigating and researching the possible financial solutions which would best meet their needs.

Financial advisers said that their investment advice was tailored to individual circumstances, with meeting cash flow requirements over the short and long-term being the primary objective.

It was agreed that the claimant's objectives are likely to be split between shorter, medium and long-term needs, and the award received will be apportioned appropriately in order to meet these. For short-term needs (described by some respondents as three to five years), it is unlikely that the claimant would invest the monies allocated to meet these as even a low-risk investment could result in capital losses or unnecessary tax charges when the future cash flow value is known.

Insurers pointed towards personal injury claimants no longer (if some ever were) investing significantly in index linked gilts as in their view they are no longer a suitable investment vehicle for claimants due to the inadequacy of the returns, and instead claimants are advised to invest in diversified lower risk portfolios reflecting their inability to make up capital elsewhere.

Financial advice firms and experts expressed caution about drawing inferences from past investment practices of claimants, particularly when the discount rate remained at plus 2.5% during a long period when risk-free real returns on investments were falling significantly below that level. Their view is that this would have forced claimants to take more risk than they (or their advisors) would otherwise have deemed prudent in order to try to make awards of compensation last longer.

They also mentioned that claimants have to manage their portfolios for an unknown period of future survival and to cover heads of damage which may be increasing faster than RPI. They commented that, given the substantial possibility that they could outlive the expectation of life, investment decisions have to be taken which will reduce the chance of the claimant running out of money if they prove more long-lived than expected, although the court's lump sum award will reflect anticipated life expectancy.

(b) Is there any regulatory material or guidance available to those providing such advice? If so, what?

Responses suggested that:

- Individuals providing financial advice to the recipient of lump sum damages must be authorised and regulated by the Financial Conduct Authority (FCA)[1] which includes being audited by the FCA, holding the necessary professional qualifications, meeting the requirements on a continuing basis to hold an annual Statement of Professional Standing and holding compulsory professional indemnity insurance.
- There is no regulatory requirement or specialist course of study/professional examination specific to advising personal injury claimants. However, the FCA does provide guidelines to which firms must adhere when dealing with vulnerable claimants and many respondents felt that many claimants fall within the regulatory definition of a vulnerable person.

Respondents mentioned that the main emphasis in these guidelines is to ensure that the advice given is fully understood, rather than intending to influence investment strategy itself.

Some respondents also commented that a large proportion of personal injury settlements are placed into Trust in order to maintain a Claimant's entitlement to Means Tested Benefits, and Part II, Section 5 of the Trustee Act 2000 provides guidance on financial advice for Trustees.

(c) Does such guidance help advisers achieve a suitable and consistent approach?

There were mixed views with some commenting that the existing guidance and regulatory material helped advisers achieve both a suitable and consistent approach, and other respondents disagreeing.

Where respondents answered no, this was on the basis that:

(i) the guidance provides advice on how to interact with consumers, but it doesn't ensure that all advisers are giving consistent advice to claimants;

(ii) that we can't expect this to result from any regulatory guidance;

(iii) (in the case of one respondent) there have been occasions when concerns have been expressed by judges about the quality and independence of advice given to claimants (on the basis of links between advisors and solicitors); and

(iv) to give a more definitive response on this topic would require more investigation, as individual parties cannot answer this question with any authority.

[1] One of the most relevant Conduct of Business Sourcebook (COBS) chapters is Part 9 – Application and Purpose Provision.

(d) Do claimants follow the advice given? If not, please explain to what extent and why.

There was general agreement that the majority of claimants do follow the advice provided.

The following reasons were cited for the minority of claimants who choose not to follow advice:

(i) because claimants prefer to use the money or meet their needs in other ways - for example by greater use of family support rather than professional care;

(ii) to provide a sum for their family upon death;

(iii) some claimants being wary of investing at all or in particular asset classes (such in the stock market) because of the risks involved, and preferring to keep their money in a bank account; and

(iv) those who felt dissatisfied by the advice provided.

Q3:

(a) To what extent do changes to financial conditions affect investment advice provided to claimants who receive a lump sum award?

31 respondents addressed this question (and 3b) in some form.

Respondents from all sectors generally took the view that short-term changes in markets do little to change or influence the long-term investment outlook or advice, although advisors may advocate phasing investments into the market to reduce any market timing risk.

Claimant groups and financial advice firms suggested that whilst the investment portfolio would be constructed in a way to adapt to market conditions, constant reappraisal of plans would be necessarily to ensure it remains suitable and within pre-agreed risk parameters –linked to this they pointed towards the difficulties in convincing claimants to invest in times of uncertainty.

(b) Is there any evidence available to show how the change to the discount rate in March 2017 directly impacted upon investment advice provided to claimants?

There was little empirical evidence provided on how the change in discount rate impacted upon investment advice provided to claimants, but respondents did give various views on the likely impact.

The ABI commissioned reports from 2 financial advice firms who stated that their advice has not changed Many of the responses from the insurance sector endorsed the ABI evidence and position. Some other financial advice firms who independently responded had similar views. Conversely claimant solicitors took the view that the risk profile of investments for claimants was likely to be lower since the change, and one asset management company highlighted that their approach has been to move to less risky portfolios.

Many respondents pointed to evidence on the impact on PPOs, and highlighted that whist the majority of claimants were electing lump sum settlements even prior to March 2017, there was a marked reduction since then. The exception being NHS Resolution, where data suggests little change and they continue to settle almost all claims on a combined lump sum/PPO basis.

It was noted by some that it is too early to see the impact of the March 2017 change because only a small number of cases have received damages under the new rate, and thus even fewer would be at the investment stage. In addition, some claimant groups and financial advisers felt that, because of the uncertainty about this review, settlements were being delayed or defendants have sought to make offers to settle using a discount rate of between plus 0.5% - 1.0%.

Q4:

(a) Please provide evidence of how recipients of lump sum damages awards actually invest, and why?

(b) What sources of balanced reliable data on investments actually made by claimants are available?

There were 29 responses to this question in some form. Very few respondents were able to provide any evidence, and responses to this question primarily came from insurers having commissioned expert advice, as well as evidence provided by financial advisers.

(a) Provide evidence of how recipients of lump sum damages awards actually invest, and why?

The responses can broadly be split into:

- Respondents <u>from the defendant perspective</u> indicated that they did not have direct access to information on how claimants invest. However, some (ABI and AVIVA) commissioned expert reports, and some insurers endorsed the ABI's material.
- The evidence received suggested that claimants were investing in either low or low to medium-risk (sometimes expressed as "cautious balanced" and "balanced") diversified asset portfolios. Several defendants also pointed to previous attempts to gather data by the Government and the conclusions drawn,[2] and stated that claimant firms have consistently failed to provide evidence, which they suggest indicates claimants in reality are not as risk averse as presumed, and in practice returns are much better than the theoretical models advocated by those firms.
- On the whole <u>responses from the claimant perspective</u> suggested they are likely to advise claimants with awards subject to the lower discount rate to take less risk, through a combination of increasing the period over which capital is phased into long term investments (and therefore holding more cash for longer) and reducing allocations to higher risk assets. Most pointed out that they are either unable to share information about portfolios due to client confidentiality and data protection regulations, and/or gathering such evidence would be a very major and time-consuming exercise, way beyond the time-scale of this Call for Evidence. Some

[2] Report of the Justice Select Committee of March 2018, the 3 consultations of 2012, 2013 and 2017, and direct engagement with wealth managers through their professional associations who worked for personal injury claimants subject to supervision of the Court of Protection.

pointed to the wide individual differences between claimants, which would make data meaningless without any understanding of the circumstances in which settlement was reached and discounts applied.

- A few respondents expressed the view that how claimants actually invested was not relevant to how the discount rate should be set.
- One financial adviser commented that ideally every claimant should have a contingency fund, retained in cash, which is available to meet unexpected expenditure, and that this should be accounted for in setting the discount rate.
- Some experts took the view that it would be difficult or impossible to gather such evidence untainted by the dynamic of under-compensation under the former plus 2.5% discount rate. They considered that claimants may have been investing in more risky assets than ILGs, and speculated they are investing in this way because they are currently being undercompensated so are compelled to take on risk (which otherwise they would not wish or be advised to do).

(b) What sources of balanced reliable data on investments actually made by claimants are available?

The overall consensus was that there is not an independent centralised source of investment data in relation to personal injury claimants, and that data would either need to be collected from some large claimant law firms or a large sample of advisors and investment houses that have been involved in providing advice to recipients of awards. However, the following sources were suggested:

- Performance of individual asset classes and funds are available from a number of reliable third party sources including Financial Express, Bloomberg, MSCI, Barclays Equity Gilt Study etc.
- Published results from appropriate investment funds: Prospect Wealth Management, IM Asset Management, Cazenove were cited.
- FTSE Private Investor Index Series was seen as a useful benchmark as a measure of returns.

Some data was provided by financial advisers and insurers on different combinations of investment portfolio, and the proportions of different assets invested within them.

Q5:

(a) What data is available regarding the profile of claimants of lump sum damages?

In general, the overwhelming bulk of responses did not provide information concerning claimant profiles -either because they did not hold any (the nature of their role meant they would not gather such information) or because they did not think it was likely to be available.

Some suggested that claimants would be drawn from across the spectrum of demographic characteristics, while others expressed the view that it would be safe to assume that certain groups (e.g., younger people, those in manual occupations) would probably feature more frequently in accidents but did not provide evidence of this.

Five respondents only provided limited information. One suggested the bulk of claimants were under 50 years of age and had life expectancies of over 30 years while another (NHSR) provided some data but accepted that its claimant base was likely to be different from those of other defendants (more very young claimants).

Another respondent observed that the distribution of those taking PPOs was slightly different to those taking lump sums, as the former were more likely to have issues of mental capacity or less predictable life expectancies. They also noted that the nature of the defendant – MIB or NHSR – also increased the likelihood of a PPO being used.

Another suggested that PPOs were more likely for cases involving longer term care needs and reduced life expectancy and also noted that PPOs were less likely in claims settled by insurers compared to NHSR, even when the circumstances of the claimants were otherwise very similar. This respondent did not gather general demographic data and suggested that their clients were drawn from all main demographic groups, but suggested that accident claimants tended to be more likely to be of working age with the longest expected durations being for those aged under 30 years of age. They said that claimants with disabilities were over-represented due to the nature of the situation which leads them to claim.

Two respondents were able to provide rather more detailed, and similar, analyses of the characteristics of claimants while two further respondents referred in their answers to the analysis done by one of these (the ABI).

The ABI collected data from its members on the profile of claimants' lump sum damages at the date of settlement covering 63% of the market (by motor and liability insurer gross written premium) and covering claims settled in the period from 1 January 2017 to 30 June 2018. ABI's data shows that claims by size are broadly uniform between the ages of 20 to 60. They also note that the Department for Transport's Road Safety Data on personal injury accidents reported to the police for 2017 suggests that 69% of serious casualties are male, with 31% female which broadly aligns with the profile of claimants of lump sum damages by gender collected from the ABI's own members.

Likewise, AVIVA suggested that, for a period after the change in the Discount Rate in 2017, 75%of claims related to RTAs while the rest were Employer Liability or Public Liability claims. The average settlement, inclusive of legal costs and damages, was stated to be £800,000. 70% of these claimants were male and 30% were female with the average age being 42 for the former and 41 for the latter. However, when weighted by the overall size of the claim, the average age of a claimant was more likely to fall into the 30-35 age bracket.

(b) How are claims of loss typically split between loss of earnings and care needs for notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively?

There were several different responses to this question (although many respondents made more than one of the comments that follow).

First, a small group of respondents (four) did not gather this type of information or did not believe there was a reliable source for it.

A common response (12) was that the question was flawed because a 'typical' split between different heads of loss was illusory as claimants varied significantly in their circumstances, meaning an award of a similar total value could be composed of damages for very different losses. Three respondents also noted that the division between different heads of loss was subject to negotiation and not always clear from the final settlement. Finally, some respondents noted that damages paid for pain, suffering and loss of amenity (not subject to the discount rate) were sometimes used for accommodation costs due to the *Roberts v Johnstone* judgement.

A second set of responses (seven, including some of the above) was that the range of settlement values included in the question was far too low given the current negative discount rate. Indeed, one suggested that £1.5m was likely to be the minimum figure just for the future care element of an award alone. However, a wide range of views were expressed as to what would now be an appropriate range which varied from £1m-£5m at the bottom end to between £20-£30m at the top of the range. In part this wide range appeared to be due to some respondents looking at the overall distribution of settlement payments whereas others appeared to be referring to 'catastrophic' settlements only.

A third set of responses did not provide detailed splits for the division of awards between different heads of loss but observed that as the overall size of the award increased, the proportion subject to the discount rate would rise (i.e., the proportion for future losses as opposed to past expenditure or for PSLA) and/or that the share of damages for care and care management costs tends to rise with the overall size of an award (mainly because the biggest awards tend to cover the longest time periods). Two respondents also noted that other heads of loss existed including legal costs, aids and equipment, and therapies and medical treatments although these were usually quite small in financial terms.

Finally, a small number of respondents (five) provided detailed breakdowns of the composition of awards by overall settlement value, including the proportion which was subject to the discount rate and, of that, the relative shares of damages for future lost earnings and for future care needs. Overall this data confirmed the more anecdotal evidence suggested above and, for three respondents (ABI, Weightman's and AVIVA) was broadly consistent with one another. In addition, two other respondents referred to the data given by one of these respondents (ABI) in their own responses suggesting they were content with this evidence. The evidence of these three respondents showed:

- For awards between £250,000-£0.5m, around 40% of the total settlement was subject to the discount rate. Of this the share relating to lost future earnings and future care and other costs was about equal at around 20% for each head;
- For awards between £0.5-£2m and between £40-500,000-£1m, around 50% of the total settlement was subject to the discount rate. The shares relating to future lost earnings and future care and other costs were broadly 40/60;
- For awards between £1m-£3m, around 65% was subject to the discount rate with the shares for future lost earning and future care costs being roughly 30/70;
- For awards between £3m-£5m, around 70% was subject to the discount rate, with the share for future care costs being much higher than for lost earning (90/10), and
- Finally, for the largest awards (above £5m), over 80% was subject to the discount rate with 74% around 90% of the award being for care, lost earnings and other future losses.

The evidence from the fourth respondent (Direct Line Group) differed in that it appeared to show lower overall proportions of settlements being subject to the discount rate (although this may be due to the way the data is presented which is different from that from the three respondents above), especially for larger claims, and the share of damages for future care losses being consistently higher for all claim sizes as compared to just the larger claims in the other data. In addition, while future care costs rose with the overall size of the settlement the rate of increase was noticeably slower than in the earlier data. However, this may be due to the way the data is presented which is different from that provided by the three respondents above.

The final respondent in this group (NHSR) accepted that its claimant profile would differ from that of other defendants (i.e., more very young claimants meaning award periods of longer expected durations). The settlement data they submitted suggested the following:

- For awards between £250,000-£750,000, 62% of the settlement was subject to the discount rate. Of this, lost earnings made up 15% and future care 47%;
- For awards between £750,000-£1.25m, 67% of the settlement was subject to the discount rate. Of this, lost earnings made up 10% and future care 57%; and
- For awards between £1.25m-£2.5m, 83% of the settlement was subject to the discount rate. Of this, lost earnings made up 14% and future care 69%.

(c) Is a period of 30 years a reasonable overall average projection period to consider when analysing long-term investment returns from such portfolios, or would an alternative period or a range of periods be more suitable, and if so, which and why?

There were 29 responses to this question. These were divided between those who think a) 30 years is too short; b) 30 years is about right; and c) it is too difficult to say due to variations between claimants. The latter response was sometimes supplemented by a call for a split discount rate based on the expected claim length.

There were 14 responses – mainly from insurers (including the ABI) and claimant lawyers, although also from some experts - which suggested 30 years was too short. Several other insurer responses reproduced the ABI analysis, while others noted that the average duration would tend to be longer due to the high share of younger RTA accident victims among claimants.

In general, a more appropriate duration was held to lie between 40 to 45 years. In several cases, the response noted that using a 30-year period was too cautious and would almost certainly result in significant over-compensation which was against the intentions of the act. Several respondents noted that claim size and expected duration would be positively correlated.

NHSR reported that many of its claims were far longer than 30 years due to the large number of babies with brain damage sustained at birth among their claimants (elsewhere the high number of PPOs made in such cases was noted). NHSR accepted that this meant that their claimant profile was likely to be atypical compared to other defendants.

There were eight responses (mainly from the claimant perspective) which suggested 30 years was about right (even though it was accepted that many claims were for a longer expected duration that this). There were various reasons given for this, including the need to prevent those with shorter claims from being under-compensated; that 30 years was a good duration because it sat between shorter and longer claims; and because, after 30 years, there were increasing uncertainties concerning inflation and real wage growth. Some respondents suggested even shorter time periods (10/20 years) for these reasons.

The final group of responses (six) suggested it is just too difficult to say what the overall projection figure should be. The main issue raised by these responses was simply that the wide range of circumstances facing claimants made the idea of a typical claim length difficult to operationalise. Among this group, there were some calls for a split rate, with the split based on the expected duration of awards.

Q6:

What evidence is available to illustrate how the following characteristics affect investment behaviours in practice?

(a) Age and expected future lifetime (e.g. longevity risk);

(b) Size of lump sum;

(c) Initial and ongoing funding requirements (e.g. care or accommodation costs);

(d) Existence and requirements of financial dependants (e.g. spouse, civil partner, children);

(e) Other protected characteristics under the Equality Act 2010 (race, sex, disability, sexual orientation, religion and belief, marriage and civil partnership, gender reassignment, pregnancy and maternity);

(f) Availability of PPOs or other sources of income.

Some responses addressed rather different issues to the ones asked. For example, several responses addressed the role of each factor in determining the size of the award, rather than how the size of the award itself might influence claimant investment behaviour.

Eight respondents suggested that they had nothing meaningful to say on this question, stating that all the factors would be relevant to certain degrees, or mentioning the need for claimants to get good financial advice concerning their investment choices. Some of these respondents did, however, go on to make comments about some of the sub-questions.

The main responses on the six specific characteristics can be summarised as follows.

a) Of the six characteristics, there was the broadest agreement that life expectancy – not age – was the main or a major factor in influencing claimant investment behaviour (20 respondents). In general, it was accepted that those with the shortest life expectancies would be the least likely to invest (or be advised to invest) in riskier assets due to the risk of short-term non-recoverable losses, and especially if they had high care needs. Mortality risk – the idea that claimants might outlive the expected term of their award and so would need to take more investment risk to provide against the risk of living longer than initially expected – was mentioned several times, although its relative importance for claimant investment behaviour differed markedly between respondents.

   Overall, claimants with longer life expectancies, who often had the largest awards, were seen as being less exposed to mortality risk and also better able to invest over the longer-term, meaning that they were better placed to invested in higher return, albeit riskier, assets.

b) The second factor where there was broad, although not unanimous, agreement on importance was on the size of the award (18 respondents). As noted above, this was likely to be bound up with the claimant's life expectancy. Four respondents, whose responses were very similar, suggested that the size of the award did not matter in relation to investment behaviour this was a minority view.

In general, larger awards were seen as giving investors a greater degree of flexibility than smaller ones, as this allowed them to take a longer-term view (in view of the size and longevity of the award) which meant being able to accept a higher level of risk (although other respondents argued that this might lead to the opposite outcome). Larger awards also allowed for the construction of bespoke portfolios, gave a greater opportunity to diversify their investments due to the existence of minimum investment requirements for certain assets, and gave the ability to obtain professional investment advice and achieve economies of scale for investment management costs (although some respondents commented this might be offset by the need to obtain more sophisticated advice on taxation).

However, the relative importance of the size of the award varied between those who saw it as being one of the two most important factors influencing behaviour, those who felt that it mattered up to a certain 'critical level', and those who considered that the size of the award might simply 'be a factor'. In addition, while two respondents noted that larger awards gave claimants more options, they also pointed out that this would usually be because the claimant had higher needs which might offset this.

Several respondents focused on the issues that could arise where the size of the award might be insufficient for various reasons. These included 'compromised' awards (i.e., due to contributory negligence and/or litigation risk) where the award was likely to be insufficient to meet the claimant's full needs. In addition, several respondents noted that for claimants whose awards contained a high proportion of future care costs which were likely to rise faster than general inflation, there would be a need to achieve higher returns to ensure that these could be met, especially over the longer term.

One respondent also suggested that, due to the way the current discount rate is set (i.e., using a three-year rolling average of ILGs returns whose recent trend has been downwards) there was an inherent issue of awards being too small leading to more risky investment choices.

c) With regard to immediate and on-going financial requirements, five respondents suggested these could be met via either capital or income and so did not really address the question of their impact on investment choices. For those that did address this issue (11 responses), accommodation and long-term care costs were the two most important issues (the latter largely for the reasons discussed above) and especially where contributory negligence and litigation risk had been issues during settlement (as above). For some respondents (eight), accommodation costs were a key issue due to the impact of the *Roberts v Johnstone* ruling which in their view means that claimants are not fully compensated because the property can form part of a subsequent inheritance. However, it should be noted that the significance of the accommodation issue was questioned by some: one respondent suggested that accommodation issues could be dealt with pre-settlement which helped to avoid this problem; while others described its impact as 'marginal' or 'only sometimes relevant'. Another issue which was raised by one respondent was the need to hold back some resources to deal with 'immediate' or unforeseen needs while another respondent suggested that some items of expenditure which claimants needed to provide for were not those which had been anticipated at the time of settlement.

d) Compared to the above, the presence of dependant relatives was seen as being far less important in influencing claimant investment behaviour. Again, a small group of respondents suggested that this was irrelevant for determining the size of the award while another respondent suggested that, if the award for loss of earnings had been correctly calculated, the presence of dependant relatives should not matter as the claimant could behave in exactly the same way as if they had not been injured. However, most respondents who answered this question (12) accepted that the presence of financial dependants mattered (although without discussing the reasons why in some cases) although some (two) suggested that meeting their needs was normally seen as being secondary to meeting the costs of accommodation and long-term care discussed above. The reasons given for why dependants were 'relevant in some cases' were: tax planning issues; where they were temporarily financially dependent on the claimant (e.g., school age children); or where the claimant had previously been a 'breadwinner'.

e) The presence of a protected characteristic was also seen as not being especially relevant to claimant investment behaviour. Seven respondents suggested that these should make no difference or that they had no evidence for them being relevant in practice. One respondent suggested that being in a marriage/civil partnership and maternity/ paternity status were the only characteristics that were likely to be 'material', although these may simply be evidence that having various forms of financially dependent relative do influence investment choices. For those respondents (11 including the one just mentioned) who mentioned at least one particular characteristic, disability was cited by four (although, in one case, this appeared to be more because of the equality impact than because it would influence investment behaviour) with one suggesting it would be especially important if the disability was associated with a reduced life expectancy. Six respondents also mentioned 'cultural' or 'religious or ethical' factors with the need to abide by Islamic investment practices being the main reason.

f) Finally, the availability of PPOs and other sources of income was generally seen to influence claimant investment behaviour although not all respondents agreed with this while others did not separate out the effects of each. Where there was a PPO in place alongside a lump sum, this was seen as making the need to invest as less important; as reducing investment opportunities as the lump sum would now be smaller; as reducing the burden of taxation; as allowing a more 'liberal' or 'flexible' attitude towards investment risk (especially in the longer-term); as allowing the capital invested to be maintained; and as helping to protect against short-term investment losses. Similar impacts were suggested for other sources of both income and wealth although one respondent suggested that most claimants would not be in such a financial position.

Many of the respondents to the last question used it to discuss wider issues about the use of PPOs. While some (four) insurers and defendants suggested that the demand for PPOs at the current discount rate was very similar to that at the previous one, two insurers responded that the demand had fallen quite sharply under the new rate. Broadly speaking, the other comments here reflected the respondents' wider interests with those on the defendant side arguing that the low uptake of PPOs mainly reflected claimant choices (with one suggesting that this could be taken as indicating a higher tolerance for risk) while those on the claimant side argued that the low use of PPOs was due to the reluctance of insurers to make them available due to the high costs of providing for them (the contrast with NHSR and MIB – who are financed in different ways to insurers - was noted by some respondents).

Q7:

(a) What taxation rates typically apply to claimants on their investment returns, and how does the distribution of these vary across ranges of different claimants?

There were many common responses to this question. One set (13 respondents) was simply to indicate that the respondent had no information or was not best placed to answer it. This was sometimes complemented by a description of the current position on tax on awards (e.g., payable on the income from lump sums but not on that from PPOs) or by broad statements about the structure, current rates and annual tax allowances found in the UK tax system but without any attempt to apply them to concrete examples.

Four respondents also noted that the level of tax payable would change over the course of life because, as the claimant aged, the amount of money invested, and therefore the income to be derived from it, would decline. Likewise, for those still able to work, there would be changes in the levels of other taxable income due to the claimant moving into retirement. Two respondents also noted that tax might be payable (indeed, might only be payable) as a result of unforeseen circumstances for which, by definition, it was impossible to plan. Finally, a small number of respondents cited changes to the tax system as being a similar unforeseen factor although one suggested that UK taxes might need to rise in the future.

However, the most popular response (18 respondents) was that the level of tax payable would differ between individuals because of their particular circumstances (i.e., there was no such thing as a 'typical' claimant) and the particular tax minimisation strategies they employed. However, most of these responses tended to note that the level of tax payable was likely to be a function of the amount invested with larger settlements generally being liable for larger tax payments which made them more suitable for tax planning. Tax planning, however, was seen as being (and sometimes demonstrated to be through the use of examples) complex, and especially so for those investing in property, equities and offshore bonds, meaning that working out the overall rates of tax payable might be 'challenging'.

While several responses discussed what the appropriate tax deduction might be as a result of such planning, only two respondents mentioned that tax planning advice was also an expense which the claimant would have to meet, although for the largest settlements this might be offset by lower investment management charges.

A final response, albeit not as common (six responses), was to note the difference in the tax treatment of income from lump sums and that from PPOs with the former being described by one respondent 'not right in principle' given that this income was compensation for an injury. However, another response suggested that making any allowance for tax would further drive up the demand for lump sums compared to PPOs. Finally, seven respondents noted that the income from lump sums was tax-free in Jersey and suggested that this might be replicated in England and Wales.

Several respondents made estimates of the effective tax rates faced by claimants based on the size of their settlement. These are summarised below in the section on question 7(c).

(b) How is the effect of taxation taken into account in determining what investments to make?

The responses to this question mainly served to complement those to the previous one. Again, several responses suggested they had no direct evidence or simply observed that it would be in the claimant's interest to consider their investment returns on a post-tax basis.

Substantive responses which provided additional information to 7(a) were relatively rare. Of these, the majority described the various ways in which either the claimant's total tax liability, or its timing, could be reduced by appropriate financial advice. Of these, the main method used to reduce the burden of tax was to ensure that the claimant's annual income and capital gains tax allowances were used in full. The other was the use of various tax 'wrappers', such as a personal injury trust, in which the assets were placed.

However, in terms of the question of how the effects of taxation might impact on the choice of investments, most responses (where made) suggested it was marginal. For example:

> *'investment qualities are the primary consideration: tax is always secondary and cannot drive financial advice'.*
>
> *'taxation will not be the main factor taken into account: diversity and risk profile, as mentioned above, will be the primary factor but, subject to that, use of appropriate investments to maximise tax breaks and tax saving will be utilised.'*
>
> *'Taxation is a consideration along with many other factors that need to be carefully considered when recommending appropriate and suitable investments.'*
>
> *'Tax planning plays a part in any sensible investment planning. Personal injury claimants ought to be advised to derive any taxation concessions that are legally available to them, provided that the tax planning does not detract from the overall flexibility, income and capital requirements that the claimant may have.'*

Perhaps because of the primacy of the nature of the investment compared to the tax treatment, one of the above respondents also suggested the scope to reduce tax liabilities was limited. However, another respondent suggested this might not always be true:

> *'The effect of taxation has a large impact on the types of investment products that we advise claimants to use. For clients with larger awards there is the possibility that they may become higher rate (40%) or additional rate (45%) taxpayers on any income they achieve. This is a very significant reduction to their return.'*

(c) What might typical average current tax rates be for notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively (and no other taxable income)?

Substantive answers to this question largely divided between those who suggested claimants would face no tax liability or one only at the basic rate of income tax and those who suggested that, especially for larger awards, a higher tax liability was normal.

Thus, one set of responses (10), mainly (though not exclusively) from insurers and many of whom cited the same source of evidence, argued, or suggested that it was safe to assume, that the 'vast majority' of claimants would face no or only a 'negligible' tax liability or would pay basic rate tax only on their investment income. This was because the size of most settlements was too small to generate income over the various relevant tax-free allowances, because settlements would be invested in ways which minimised any tax liabilities and because most claimants would not have other sources of taxable income (e.g. from employment or self-employment). One respondent also noted that many claimants would also have access to tax free services provided by the state (e.g. local authorities).

Next, there were 12 responses which sought to provide more concrete figures for the magnitude of any adjustment for tax purposes (although it should be noted that many cited the same source of information in support of their position) or critiqued those already proposed. Among the latter group, one respondent argued that the deduction originally proposed by GAD (in its 2017 report) of 0.5% per annum for both taxation and management charges was about right, while two responses, drawing on those cited in the previous paragraph, argued that the revised deduction proposed by GAD for tax only (0.1-0.5% per annum) was too high while another respondent suggested that the upper bound of this range was slightly too high and suggested 0.4%instead.

Another respondent urged the government to be cautious in setting the deduction as it would need to apply to a wide range of settlements, while it also noted (as described above) that UK taxes were currently quite low and might be expected to rise in the future.

Seven respondents provided their own estimates of the likely tax liability (although each was based on a particular set of circumstances and assumptions). One respondent took the suggested GAD portfolios and, while ignoring the scope for tax efficient investments, suggested the average tax rate paid would be 15% on an award of between £0.5m-£1.5m whereas, for longer awards this would increase to 24%.

Likewise, another respondent, based on their own experience, suggested that claimants with awards between £0.5m-£1.5m would be basic rate taxpayers only. In addition, two respondents provided detailed calculations for how the tax liability might increase with the size of the award. Of these, one suggested that it would be prudent to assume for lump sum settlements worth £2m or below that the claimant would face the basic (i.e., 20%) marginal rate of tax whereas, for settlements above this level, the higher (i.e., 40%) rate would apply. The other respondent, albeit using different assumptions (including a very long expected award period) argued that, at particular points in the life course, claimants with lump sum settlements under £0.5m would probably face no tax liability, that those with settlements of around £1m would probably pay basic rate tax only while those with £1.5m or more would likely pay the higher marginal rate.

Finally, three respondents (all representing claimants) cited the same example of a large settlement where the tax deduction had been between 0.5-0.75% and used this to argue for a deduction at the bottom end of this range.

Q8:

What evidence is available regarding the average long-term rates of inflation which apply to costs typically experienced by claimants in aggregate, and how do these compare to each of RPI, CPI, CPIH and earnings inflation?

There were 33 responses to this question, although 2 were vague or simply suggested that the choice was up to 'financial experts'. Thus, while there were 31 substantive answers, none provided actual evidence or directly addressed the question posed. Rather, respondents provided views on what inflation measure should be adopted when setting the rate. A small number of responses (three) responded to the question by providing evidence on the change in each index without commenting on which they preferred, or simply described the current practices for taking inflation into account in awards. One further response simply endorsed the approach described by GAD in the technical document.

Of those who addressed the substance of the question, three responses explicitly rejected the use of the RPI but did not state how it should be replaced. Of the remaining 24 responses, the majority (16) opted for a particular index while eight suggested that the choice was dependent on whether more than one discount rate was to be set, that the appropriate measure of inflation should be calculated on a pragmatic basis or supported different price indices for different heads of loss. Where different discount rates were to be set or heads of loss treated differently, RPI and CPI were equally supported for price related changes while earnings measures (ASHE) were favoured for lost earnings, pensions and care costs.

Of those who stated views about a preferred measure, five respondents opted for the CPI (four insurers, one expert). This was mainly on the grounds that it was the Government's preferred measure of inflation and, as such, liable to be more predictable. The various technical issues with the RPI were also a reason for this choice as was its use elsewhere and international consistency (these reasons also appeared in some of the responses of those who rejected the RPI without nominating an alternative index of inflation).

Conversely nine respondents opted for the RPI (six insurers, one expert and two lawyers) while one further respondent (lawyer) endorsed RPI although they suggested that it might not always fully reflect the price changes experienced by claimants. In the case of the insurers, it was clear that most were endorsing the use of RPI because this was the ABI's policy position (which the ABI had supported in 2017 and whose views had remained unchanged).

Earnings related measures (ASHE) were only favoured by two respondents for the full award although another (an expert) supported the use of ASHE if only one discount rate was to be set (on the grounds that, ultimately, all losses would be sensitive to the inflation in earnings growth). The remaining seven responses suggested a mixed or pragmatic approach to incorporating inflation. This involved, if one discount rate was to be set, combining various inflation measures (CPI, RPI, ASHE) into a single index for the purpose of adjusting for price changes. Others supported applying different measures for different heads of loss (ASHE for earnings-related losses, CPI/RPI for price related losses – as per PPOs) or setting more than one discount rate with different inflation measures used for each.

In general, it was accepted that (historically) earnings had tended to rise faster than RPI but several respondents, when opting for the RPI measure over ASHE, observed that this relationship had not been the case in recent years meaning that there was little to choose between ASHE and RPI in this area (hence supporting the continued use of RPI). Those who favoured ASHE focused on the longer run trend and suggested that the recent relationship between the two indices was temporary and likely to revert to the long run trend.

Q9:

(a) What investment management costs would notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively pay in practice and how are these costs broken down into different areas?

(b) To what extent would a "properly advised" investor need to incur all of these costs, for example in relation to active or passive investment of funds?

Most respondents did not answer the two questions separately and some of the that comments that were made in response to b) were often more relevant to answering a). There were only five responses (primarily from financial advisers) which provided information about the breakdown of costs between different areas – i.e. financial adviser fees, fund management fees and other associated costs (such as platform fees and transaction charges).

A number of responses (seven) provided taxonomies of the various investment management charges paid by claimants. In general, despite the different terminologies used, these descriptions were generally similar. One respondent also noted the difference between investment management costs and the costs of obtaining financial advice and suggested that claimants would need to purchase both, although two respondents noted that initial financial advice was funded by defendants at settlement.

Several respondents (six) stated that they did not have the information to answer the question or that others would be better placed to do so. A further seven suggested that providing a definitive answer to the question would be difficult due to the wide range of charges levied by investment managers, the diverse nature of the portfolios and the products included within them, the management style adopted (active/passive) and individual claimant circumstances. For example, two respondents noted that charges could range from 1.5 or 1.8% for an actively managed fund to only 0.25% for a passive, non-advised, approach. Two respondents also mentioned that, in their opinion, the current level of management charges was too high, unrelated to investment performance and simply reflected the role of vested interests. This contrasted with another response which suggested the market was largely competitive meaning that investment management charges would tend to be driven down to the minimum.

There were two broad area of agreement among respondents. The first was that there were likely to be economies of scale in investment management costs, meaning that the fees charged would fall with larger settlements. The second was that actively managed funds were generally more expensive than passively managed ones. Among defendant interests, this created a preference for the latter but two other respondents suggested that this might not always be the case – especially in a falling market and/or where the claimant was keen to avoid volatility or losses on their investments. One respondent suggested that the active/passive debate was on-going and unlikely to be resolved.

Several respondents, mainly on the defendant side, suggested higher management fees associated with a more active management style should be ignored when determining the appropriate deduction, as they would be associated with commensurately higher investment returns. They also suggested that the lack of evidence on investment returns from financial advisors supported this and that well-informed claimants would simply shift to cheaper managers if this were not the case. However, another respondent noted that claimants are not ordinary investors as meeting a stream of future liabilities is their primary concern rather than returns. Therefore, claimants need advice to manage cash flows and risks, which add nothing to returns.

The responses which provided information about the breakdown of fees between different components suggested the following splits:

- Financial adviser fees ranging in the region of 0.25% to 0.5% pa (with a consensus around 0.5% pa)
- Fund management charges between 0.2% pa of funds under management (for more static funds) to around 1% pa (for smaller or more active funds), plus VAT at 20%.
- Platform fees of up to 0.25% pa

For more active investment approaches there could be other fees payable (perhaps up to 1% pa, including platform fees).

In terms of substantive answers to the question concerning the likely level of investment management costs paid by claimants, the respondents fell into three main groups. The first group (eight respondents, including three who largely referred to the ABI response with no discussion of specific issues) and comprised mainly (though not completely) of insurers, argued in favour of the initial GAD figure of 0.5% for tax and management charges and noted that this was the figure used in the recent Scottish legislation on the discount rate. A further respondent suggested 0.25% for investment management costs alone (although this was based on the assumption that a passive management approach would be used). The ABI response made reference to a report by Pannell's which suggested that the range could lie between 0.7 and 1.3% for investment management costs alone (where investments were managed by a discretionary fund manager which was seen as the normal arrangement), and could be even higher for larger awards. However, the response endorsed the initial, and much lower, GAD estimate for this deduction.

A second group of respondents suggested that the level of investment management costs was slightly higher than the initial GAD estimate. Thus, two respondents (both insurers) suggested a range of 0.5 to 1% (although one suggested this should include the deduction for taxation as well) while another (a lawyer) noted such costs could be 1% but, in practice, 'are regularly more' than this. A final respondent suggested a figure 'in excess of' 1% if the funds were to be managed actively.

The final group of eight respondents, mainly representing claimants, provided estimates based on actual experience for investment management costs which generally ranged between 1.5-2% although one estimate went as high as 2.1-2.4% while another quoted an upper bound of 2.3% (although it claimed to try and keep the figure down to under 2% where possible). Thus, one claimant lawyer suggested an average figure of 1.5% (with a range of between 1.1-1.9%) while a financial advisor suggested 'at least' 1.6% even for a low risk, cautious, globally diversified portfolio. The remainder all suggested the 1.5 to 2% range. Both PFP and FOCIS (the latter based on a survey of investment managers) quoted a range of 1.5-2%with the latter suggesting a mean of 1.78%which it confirmed was consistent with their clients with portfolios worth up to £1.5m. A financial adviser also suggested a range of 1.5 to 2% for smaller, fairly actively managed portfolios.

Another respondent suggested the range of fund values suggested by the question was unrealistic due to the current negative discount rate and three suggested the management costs would be similar for the three fund sizes. Two of the above respondents also provided management cost estimates for the fund sizes specified: FOCIS suggested its survey yielded an average figure of 1.77%for portfolios worth up to £1.5m and 1.53% for those worth more than this; while Adroit estimated that the management costs associated with a portfolio of £0.5m would be 1.75%; for one worth £1m they would be 1.71%; and for a fund of £1.5m they would be 1.68%, although they also noted that access to tax efficient products could raise these costs further.

Those who responded directly to this question (mainly investment managers and defendant lawyers) were generally sceptical of the scope for reducing management costs much below the ones they had cited earlier. There were various reasons given for this: the costs were all necessary if the claimant was to be properly advised; if the claimant could obtain adequate advice more cheaply elsewhere they would; many of the costs reflected the high level of engagement required of investment advisors; or simply that it would not be possible for most claimants to avoid paying the various costs described. One respondent noted that claimants would also need to pay financial planning costs.

The main way by which costs could be reduced was, as noted above, shifting from an active to a passive fund management approach. One respondent suggested that seriously injured claimants generally avoided the former while another considered that such an approach was not 'realistic' for smaller funds (although there could be conflicts with fund managers who would favour a more active approach as a means of ensuring their costs could be met). However, one respondent noted, also as above, that a passive style was not always appropriate, especially in a falling market, although they also suggested that the costs of active management were falling. One respondent (a claimant lawyer) suggested that it was their practice to refuse to pay certain administrative fees.

Q10:

(a) Please outline your views on how well each of the notional investment portfolios (i), (ii) and (iii) set out above would match the criteria for the investment approach to be assumed under the Civil Liability Bill (as summarised in paragraph 18 of this Call for Evidence).

(b) Please provide your views of an asset class distribution of a portfolio which would best meet those objectives (which may or may not be aligned with one of the notional portfolios (i), (ii) or (iii) listed above).

The responses to this question varied and gave multiple reasons for why some investment portfolios are better designed than others for personal injury claimants.

A majority of respondents (including insurers, lawyers and financial experts) either agreed with one or more of the suggested portfolios or thought that the ideal portfolio would fall somewhere within the suggested portfolio ranges.

Amongst those who supported a portfolio, three respondents supported portfolio ii) arguing, among other things, that it provides a good balance between liquidity, growth and diversification. Two supported portfolio iii), although one of them argued that claimants should use a more conservative portfolio that would exclude ‘other types’ of assets as they might be difficult to calibrate and rarely used in practice. One supported portfolio i), arguing that the additional (investment) risk would not raise the probability of meeting the required cash flow by much.

Among those who supported various of the suggested portfolios, one respondent supported portfolios ii) and iii). Finally, another respondent suggested that all three suggested investment portfolios were in line with the investment approach assumed under the Civil Liability Act, while highlighting that there is no ‘one size fits all’ asset allocation.

Six respondents (all form insurer industry) took the view that portfolios i) and ii) were underweight in their overall allocation to equities (UK and overseas), whilst portfolio iii) was overweight. Instead, they supported an investment portfolio with an allocation to equities of around 40%.

Finally, five respondents (two financial experts, two lawyers and one actuary) took the view that all proposed model portfolios would be too risky to meet the objective of full compensation. It was suggested that great exposure to equity and investment in ‘other types’ of assets were inconsistent with a low risk approach. An alternative portfolio was suggested which excluded high risk ‘other types’ category, had lower allocation to equity and higher allocation to corporate bonds.

A small number of respondents shared what they considered suitable portfolios, including upper and lower bounds of risk tolerance acceptable within the legislative framework.

On asset class distribution within portfolios (part b of the question), there was a broad mix of allocations between growth and matching assets. Insurers and financial planners provided evidence suggesting a range of between 30%-55% allocated to growth assets in low risk portfolios.

Q11:

Please outline your views on how the appropriateness of the portfolios outlined in Q10 would alter for claimants within a reasonable range of different characteristics under the following criteria (all other things being equal):

(a) Age and expected future lifetime

(b) Size of lump sum

(c) Initial and ongoing care funding requirements

Of the 40 responses, 22 directly answered this question in some capacity. A majority of respondents took the view that the factors listed in this question should not be considered individually, but should be considered together.

a) The general view was that age and future life expectancy would be crucial factors in assessing the risk of an investment portfolio and its ability to achieve the desired return. Long life expectancy was associated with portfolios containing a higher proportion of equities; while short life expectancy with portfolios containing a greater proportion of bonds. Short life expectancy therefore would be more likely to result in under-compensation in each of the model investment portfolios.

b) Five respondents argued that, although the rate of taxation would increase for higher lump sums, the size of the lump sum would not have a substantial impact on investment decisions or likelihood to receive the expected return. However, the majority of respondents took the view that the suitability of a portfolio could be determined when the size of lump sum was considered together with the time horizon. It was suggested that equities would constitute the largest part of the investment portfolio if claimants had to invest a large lump sum over a long-time horizon.

c) The general response to this aspect was that the portfolio should be designed to meet cash requirements as initial and ongoing care funding requirements would be cash flows. It was suggested that cash could be retained to cover the initial period and the portfolio would generate enough income to cover ongoing care costs in other periods. These portfolios might be biased towards holding higher-yielding investments that would allow funding of ongoing care expenditure requirements.

A majority of respondents also suggested that if a single rate was retained it should not be skewed in favour of the minority of claimants with short-term losses against the vast majority with longer term losses and needs.

Q12:

(a) Are there similarities between the ways that lump sums awarded in personal injury cases are invested and how individuals choose to invest other funds, for which data might be more readily available?

(b) For example, would data regarding defined contribution pension investments be of relevance – both in the way that funds are invested prior to initial withdrawal, and how these funds are managed in retirement (for example through income drawdown)?

(c) Would any other financial products be useful to consider, and if so, what data and information is available on investment decisions for such products which could be useful in this exercise to develop a proxy for how personal injury claimants might invest lump sums?

a) The majority of responses (16) took the view that private investors and personal injury claimants could not be directly compared. The main argument was that seriously-injured claimants might not have any other income and therefore would take lower risk than the average investor as they would not want to exhaust funds before death. It was also suggested that injured claimants would be effectively forced to invest to meet their disability-related needs, whereas typical investors would only invest if they chose to do so. Therefore, personal injury investors would come under the definition of a ‘vulnerable client’ as provided by the FCA.

One respondent (of the 16) made an analogy between the personal injury claimant’s lump sum and a pension fund and suggested that the Lord Chancellor would have a role similar to that of professional trustee of a pension fund. In this context, Lord

Chancellor would have to consider the principles of the Purple Book[3] which would require a significantly lower risk portfolio than those proposed in the Call for Evidence.

b) 13 respondents argued that whilst a claimant and pensioner might have similar investment strategies because of the nature and reason for investment, there would still be large differences between these two groups of investors. Vulnerability of personal injury claimants, unavailability of alternative income sources, and the need to provide for a longer period were the paramount considerations. It was also suggested that advantageous taxation of pension funds would result in better performance. This analogy should be therefore used with care.

c) The vast majority of respondents either were not aware of any other financial products or did not provide an answer. Two respondents suggested annuity-type products as a possible alternative, one respondent suggested investment ISAs and two respondents made a reference to the available data on expected growth rate (EGR) quoted for various investment products.

Q13:

Do you have any other data or evidence to provide that you consider to be relevant to this Call for Evidence? If so, please provide it and explain its relevance.

The great majority of respondents (27) did not answer this question or were not able to provide any data or evidence. Of those who were able to provide some evidence, some indicated that the Government should consider a dual rate approach, and that whilst such an approach might add more complexity to the process, it would be more likely to support and achieve the 100% compensation principle.

Other suggestions:

- While evidence was limited, two respondents argued that the discount rate of minus 0.75% was too low and a higher long-term discount rate would be more appropriate.
- One respondent suggested that a liability-matching approach would allow claimants to achieve the 100% compensation principle. Some evidence provided showed that all three proposed model portfolios would be too risky for the primary purpose of liability-matching in the context of individual claimants.
- One respondent from the insurance industry suggested exempting income on personal lump sums from taxation on the grounds that this would minimise the impact of the discount rate in cases settled by the NHS.

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[3] The Purple Book, published annually by the Pension Protection Fund, provides comprehensive data on the UK Universe of Defined Benefit (DB) pension schemes in the private sector.

Q14:

Please provide evidence of how the setting of the discount rate under the new law will affect persons with protected characteristics.

Of the 40 responses, 25 directly answered the question in some capacity. Most of the responses were from insurers and lawyers. A majority of respondents (15) took the view that the setting of the discount rate under the new law would not affect people with equality protected characteristics any differently from those without such characteristics. It was therefore suggested that all claimants affected should be considered equally.

By contrast, 10 respondents took the view that the setting of the discount rate under the new law would have an impact on persons with protected characteristics. Of those, most suggested persons with an ongoing disability would be most affected. A few respondents suggested that old, young and infirm people would also be substantially affected.

A small number of other responses did not answer the question directly, with some of these suggesting that all claimants as a group would be treated less favourably than comparison groups (e.g. pensioners in defined contribution schemes). Those in comparison groups would be likely to face less risk than proposed in model investment portfolios. One respondent suggested that Sustainable and Responsible Investment (SRI) style investors would be disadvantaged as it wouldn't always be possible to replicate the 'standard' portfolio so that it would be in line with SRI principles without greater exposure to equity or accepting lower returns.

Glossary of terms used in this response

ABI	Association of British Insurers
CPI	Consumer Price Index – measure of inflation
GAD	Government Actuary's Department
ILGs	Index-Linked Gilts, a form of investment asset
MIB	Motor Insurers' Bureau, handle claims from road traffic accidents where party is uninsured
NHS	National Health Service
NHSR	NHS Resolution, agency handling personal injury claims against the NHS
PPO	Periodical Payment Order, method of paying damages in instalments over a period of time.
RPI	Retail Price Index – measure of inflation
RTA	Road traffic accident

Equalities and Welsh Language

Equalities

The Public Sector Equality Duty (PSED) came in to force in April 2011 and public authorities, including the Ministry of Justice, are required to have due regard to the need to achieve the objectives set out under section 149 of the Equality Act 2010 to:

(a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;

(b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;

(c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

The proportionate Equality Analysis that accompanied the Call for Evidence should now be updated in light of the Call for Evidence responses to consider likely impacts on people with protected characteristics: disability, race, sex, gender reassignment, age, religion or belief, sexual orientation, pregnancy and maternity, marriage and civil partnership.

We have drawn attention, in the Call for Evidence, to the way in which the personal characteristics of the claimant (including the protected characteristics) may influence his or her decisions. We asked for evidence that indicated whether the setting of the discount rate under the Act would affect persons with protected characteristics. The Equality Assessment, prepared for the Civil Liability Act 2018, will be re-examined during the first review of the personal injury discount rate.

More information on the PSED can be found here:
https://intranet.justice.gov.uk/documents/2015/04/psed-guidance.pdf

Welsh Language Impact Test

In accordance with the Welsh Language Act 1993, the MoJ's Welsh Language Scheme, we will translate an executive summary of this report.

Further guidance can be found here: https://www.gov.uk/government/publications/moj-welsh-language-scheme-2018

Next Steps

1. The Call for Evidence is designed to assist the Lord Chancellor in making his decision on the first review of the personal injury discount rate.

2. Under the new legislation (the Damages Act 1996 as amended by the Civil Liability Act 2018) the discount rate will reflect the rate of return to be expected on a low-risk diversified portfolio. The new legislation also requires the Lord Chancellor to make a number of assumptions – such as a claimant being properly advised on making investments, as well as having regard to the effects of taxation, inflation and investment management costs. The evidence and data gathered in this exercise will inform the decision-making process. The Lord Chancellor must apply the legal principles set out in the legislation to decide where in the range of low risk the rate should be set.

3. Following the Call for Evidence, the Lord Chancellor consulted the Government Actuary's Department and HM Treasury. Their analysis and advice will be considered alongside the data and material received in the Call for Evidence.

4. In accordance with the statutory timetable, the Lord Chancellor initiated the review of the rate 90 days after Royal Assent (19 March 2019). The review will be completed within 180 days. The new rate will be announced no later than 5 August 2019. The new rate will come into force on a date to be fixed by the Lord Chancellor.

5. The Government will, alongside announcing a new rate, publish a statement of reasons. This document will set out the Lord Chancellor's conclusions and the assumptions and judgements made in reaching his decision.

6. The personal injury discount rate set at the end of this process will be reviewed within five years, beginning from the day which this review was concluded. Under the new legislation, in the next review the Lord Chancellor must consult an expert panel, which will be established for the review and chaired by the Government Actuary, alongside the Treasury.

Consultation principles

This Call for Evidence was conducted in accordance with the principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation.

Cabinet Office Consultation Principles 2018 that can be found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691383/Consultation_Principles__1_.pdf.

Annex A – List of respondents

Adroit Financial Planning
Ageas and Tesco Underwriting
AIG UK & Europe
Allianz UK
Anthony Collins Solicitors LLP
Association of British Insurers (ABI)
Association of Personal Injury Lawyers (APIL)
AVIVA
Axa UK
BLM Law
Chris Daykin
DAC Beachcroft Claims Ltd
Direct Line Group
DWF LLP
Forum of Complex Injury Solicitors (FOCIS)
Forum of Insurance Lawyers (FOIL)
Frenkel Topping
Hugh Gregory
Ian Gunn & Richard Cropper
IM Asset Management
Institute and Faculty of Actuaries
International Underwriting Association
Irwin Mitchell LLP
Keoghs LLP
LV=
Medical Defence Union
Medical Protection Society
Motor Accident Solicitors Society (MASS)
Nestor
NFU Mutual
NHS Resolution (NHSR)
Personal Investment Management & Financial Advice Association
Professor Victoria Wass
RSA Broker
SCOR Global
Serjeants' Inn
Stewarts Law LLP
Thompsons Solicitors
Weightmans
Zurich Insurance plc

Alternative format versions of this report are available on request from discountrate.evidence2018@justice.gov.uk.