Review of the Personal Injury Discount Rate

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Expert Panel report to the Lord Chancellor

Foreword

As Chair of the Expert Panel, I am pleased to submit our advice to the Lord Chancellor in relation to her consideration of the Personal Injury Discount Rate (PIDR). This report has been prepared in accordance with the letter of 15 July 2024 from the Lord Chancellor and our Terms of Reference. We understand that it will be made public alongside other documents relevant to the determination of the Personal Injury Discount Rate.

This is the first review to involve an Expert Panel to provide independent advice to the Lord Chancellor. The purpose of the Expert Panel ('the Panel') is to bring additional experience and expertise to the review process. I would like to thank my fellow Panel members Charl Cronje, Dr Rebecca Driver, Donald Taylor and Ed Tomlinson for the dedication, effort, challenge, and expertise they have brought to the process. More details on the Panel's approach are set out in this report and I am pleased to confirm that this report reflects our collective advice.

The PIDR is an essential part of calculating fair compensation for individuals who have suffered potentially life changing injuries. Our advice is framed as a potential range for the PIDR, with associated probabilities of achieving sufficient, over- or under-compensation for claimants, reflecting the fact that a claimant's individual circumstances will determine their outcome.

Given this, no single PIDR will be exactly right for all claimants. In setting out our advice, we have tried to make clear how different claimant groups might be affected. We have highlighted the judgements and assumptions we have made, any data limitations, and where the results are likely to be particularly sensitive to modelling assumptions. We have also sought to ensure that the range of circumstances and lived experience of claimants is fully understood and remains visible. The aim of this is to help the Lord Chancellor with her deliberations on the choice of the PIDR.

Ultimately, the Lord Chancellor is responsible for determining the PIDR. We are available should she wish to consult us further in relation to this advice.

We would like to thank everybody who has contributed to this important process. We have drawn on evidence from stakeholders and commissioned analysis from the Government Actuary's Department. We have also been supported by a secretariat from the Ministry of Justice.

Fiona Dunsire, Government Actuary and Chair of the Expert Panel

25 September 2024

Executive summary

Review background

Where damages for personal injury take the form of a lump sum payment in relation to future losses, the amount is determined using the Personal Injury Discount Rate (PIDR). This is defined as the rate of return that a recipient of damages (referred to as a claimant throughout this report) could reasonably be expected to achieve, after allowing for damage inflation, expenses, and tax.

The Civil Liability Act 2018 (CLA) describes the way that the PIDR is determined by the Lord Chancellor and sets out the requirement to consult an Expert Panel ('the Panel') for this and future reviews. The Terms of Reference in Appendix B, together with the letter of consultation from the Lord Chancellor in Appendix C, set out the factors that we, as the Panel for the 2024 review, must consider in forming our advice. This report provides our advice to the Lord Chancellor, together with the rationale and assumptions underlying that advice.

We have drawn on a range of information to select the assumptions underpinning our advice, including the responses to two Calls for Evidence issued by the Ministry of Justice. We have also commissioned analysis from the Government Actuary's Department (GAD) to support our decisions on appropriate assumptions and to quantify claimant outcomes under different potential PIDRs. The GAD Analytical Report will be made public alongside this report.

Approach to assessing claimant outcomes

Understanding claimant outcomes for different claimant types at different potential PIDRs has been key to our work. By 'claimant outcomes' we mean the likelihood that for a given set of assumptions, a claimant will receive sufficient compensation and, if not, the extent of potential under- or over-compensation. By 'sufficient compensation' we mean that all of a claimant's expected future needs (including the impact of damage inflation) are met, and no more, through a combination of the lump sum award and investment returns (after expenses and tax).

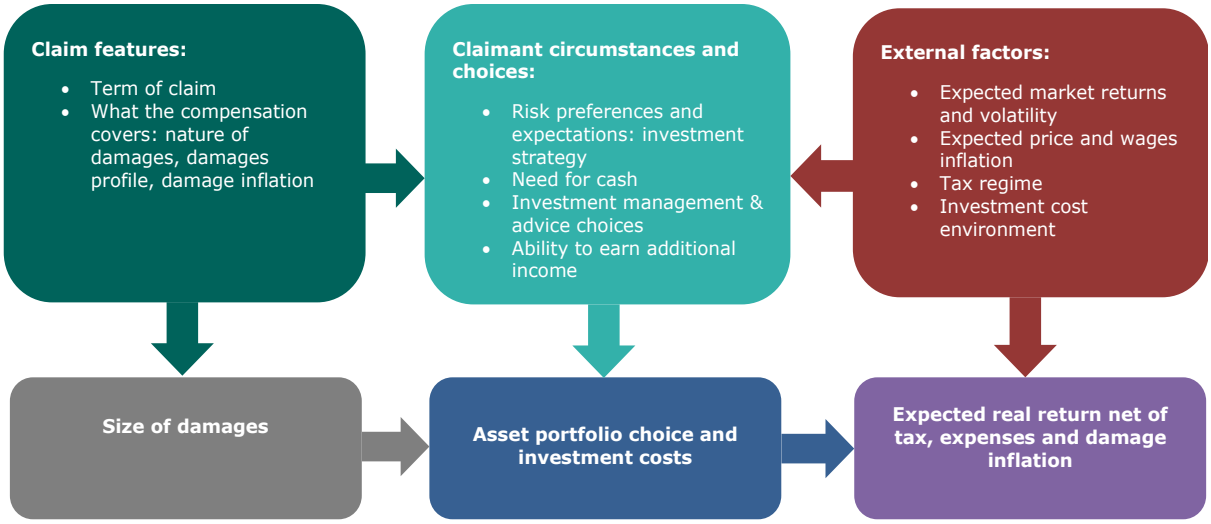
In considering claimant outcomes, we have been conscious of the balance between:

- the ***likelihood*** that a claimant, or groups of claimants, are under-compensated, whilst others are over-compensated; and
- the ***extent*** to which a claimant, or groups of claimants, are potentially under-compensated, whilst others are over-compensated.

Key factors that influence claimant outcomes are:

- claim features, encompassing the nature of damages, which influences the rate at which damages are expected to rise over time, the term over which they are expected to extend, and ultimately the size of the damages;
- claimant choices and circumstances such as risk preferences and expectations, choice of investment portfolio, approach to financial advice, investment and tax management, and ability to earn additional income; and
- external factors which influence the investment returns available, the rate of price and earnings inflation, tax regime and the investment cost environment.

Their interactions are summarised in the diagram below:



No single PIDR will be exactly right for all claimants. Therefore, to understand claimant outcomes, the approach we have taken is to define three core claimant types. These are designed to reflect a range of key characteristics of the claimant universe by size and term of damages, by investment strategy and by other taxable income. These are referred to as the '20-, 40- and 60-year claimants' in this report. Unless otherwise stated, all references to claimants by term relate to the overall characteristics of these core claimant types. Full details are set out in Section 5 of this report and summarised below.

	Core claimant type		
	20-year	**40-year**	**60-year**
Investment term	20 years	40 years	60 years
Investment strategy	Cautious	Central	Less cautious
Lump sum size	£500k	£1m	£5m
Other taxable income p.a.	£30k	£7k	£7k

We have then made assumptions about the factors that influence claimant outcomes (such as tax, expenses and damage inflation) that would in our view be consistent with the core claimant types. We have not allowed for any margin for prudence in the assumptions.

These core assumptions, along with simulated investment returns produced by two economic models, have then been used to derive the median net real returns for each of the core claimant types. These are set out in the table below.

Core claimant type	Median net real return p.a.
20-year	**0.7%**
40-year	**1.4%**
60-year	**1.0%**

For a particular core claimant type, if the PIDR was set to the median net real return (and all other assumptions are borne out in practice), they would have a 50% likelihood of receiving at least sufficient compensation, and a 50% likelihood of under-compensation.

It is not possible to set the PIDR at a single level that has a relatively high likelihood of achieving sufficient compensation without there also being a chance of over-compensation. Nor is it possible to achieve the same likelihood of sufficient compensation across all claimant types.

To support the Lord Chancellor's decision on the appropriate balance between the risk of under-compensation and setting the PIDR at a level which may be considered to have too high a likelihood of over-compensation, we have provided analysis on the extent and probabilities of over- and under-compensation across the core claimant types and a range of PIDRs.

In recognising the significant range of outputs from the analysis and the need to produce a tangible set of recommendations, we have underpinned our work with some key principles as follows:

- **Claimants receive at least sufficient compensation**. We recognise that it is not possible to guarantee sufficient compensation for all claimants in all circumstances. Therefore, we have focused on options where claimants are more likely to be over-compensated than under-compensated. That is, they have a likelihood of 50% or more of achieving at least sufficient compensation.
- **High risk of significant under-compensation should be avoided**. We define significant under-compensation as less than 90% of a claimant's future needs being met (90% sufficient) and aim to reduce the likelihood of this.

- **Significant over-compensation should be limited to the extent possible.** We define significant over-compensation as more than 120% of a claimant's future needs being met (120% sufficient, or 20% over-compensated). We therefore aim to reduce the likelihood of claimants being more than 20% over-compensated.
- **Subject to the above, limiting the likelihood and extent of under-compensation should be given greater weight than limiting over-compensation.** We therefore compare the likelihood of achieving less than 90% sufficient compensation with the likelihood of being more than 20% over-compensated.

We have used our judgement to define 90% and 120% sufficient compensation as levels of significant under- and over-compensation respectively. We consider these to be appropriate levels, given our objective that the risk of under-compensation is of a greater concern than the risk of over-compensation. The range also reflects the fact that outcomes are not symmetric around the median investment return.

These are necessarily subjective judgements, and we have also considered analysis of additional compensation levels (for example 10% or 30% over-compensation). Whilst this analysis does produce different likelihoods, the comparisons of the relative merits of the options for the PIDR are consistent with those we arrived at using a 20% over-compensation level.

The Lord Chancellor will ultimately need to decide on the appropriate compensation levels and likelihoods. Whilst the framework above will be helpful in this regard, a wider range of outcomes is included in the GAD Analytical Report.

Our assumptions are based on our view of the evidence available, and external factors in place at the time of this report (for example, the investment environment, tax regime etc). Whilst this evidence has been carefully considered, we recognise the limitations around it. As such, judgement is required in a number of areas on what assumptions are most appropriate. The details of how we have made these judgements are set out in Section 5 of this report, with more analysis in the GAD Analytical Report.

We recognise that it is also possible to produce other assumptions that are plausible based on the same evidence. To ensure the robustness of our advice, we have sought to quantify the potential effect of these alternative assumptions by considering their impact on the outcomes for the core claimant types. We also consider outcomes for a wider claimant group, with characteristics outside the core claimant types.

The Lord Chancellor has the option of setting different rates for the PIDR for different claim types to improve the likelihood of achieving at least sufficient compensation for different claimant groups. We have therefore also considered the potential impact of setting a PIDR which varies by the length of term or by heads of loss (referred to as a dual rate or multiple rates).

Summary of single rate analysis

The CLA does not specify the level of precision required, and this is a decision for the Lord Chancellor. The more detailed background analysis quoted in this report does in places quote PIDRs to the nearest 0.1%. Given the uncertainty within the assumptions and approach, our summary advice below is presented on PIDRs rounded to the nearest 0.25%. This avoids spurious accuracy and aims for simplicity. Neither of these rounding conventions is intended to restrict the Lord Chancellor's decision on the PIDR.

Based on our assumptions, the analysis suggests that the existing PIDR (of -0.25%) creates a significant likelihood of over-compensation, as highlighted by the 40-year and 60-year claimants. Mitigating this risk of over-compensation would require an increase in the PIDR. To assist the Lord Chancellor, we have considered outcomes for the core claimant types for PIDRs in the range +0.5% to +1.5%.

At least 100% and 90% sufficiency

The table below sets out the likelihood of the core claimant types achieving at least 100% sufficient and at least 90% sufficient compensation under different potential PIDRs. Those scenarios with more than a 50% likelihood of achieving at least sufficient compensation to meet their needs are highlighted in bold and grey shading.

		Core claimant type					
		20-year		40-year		60-year	
		Likelihood of achieving a compensation level of at least…					
		90%	100%	90%	100%	90%	100%
PIDR	**-0.25%**	93%	**76%**	95%	**89%**	88%	**81%**
	…						
	0.50%	83%	**55%**	87%	**76%**	75%	**64%**
	0.75%	78%	47%	83%	**69%**	70%	**58%**
	1.00%	73%	40%	78%	**63%**	64%	**50%**
	1.25%	67%	32%	72%	**55%**	57%	43%
	1.50%	60%	25%	66%	48%	50%	36%

Significant under- versus over-compensation

The table below sets out the likelihood of significant under- and over-compensation across the core claimant types.

		Core claimant type								
		20-year			40-year			60-year		
		Likelihood[1] of achieving a compensation level of…								
		less than 90%	90-120%	more than 120%	less than 90%	90-120%	more than 120%	less than 90%	90-120%	more than 120%
PIDR	-0.25%	7%	73%	20%	5%	26%	69%	12%	25%	64%
	...									
	0.50%	17%	76%	7%	13%	42%	45%	25%	34%	41%
	0.75%	22%	74%	5%	17%	45%	37%	30%	37%	33%
	1.00%	27%	70%	3%	22%	48%	30%	36%	38%	26%
	1.25%	33%	65%	2%	28%	50%	22%	43%	38%	19%
	1.50%	40%	58%	1%	34%	51%	16%	50%	36%	14%

Key findings

The key points from the tables above can be summarised as follows:

- A PIDR of 1.5% does not satisfy the principles against which we have assessed options for the PIDR:
  - none of the core claimant types have a 50% likelihood or more of achieving at least sufficient compensation. Thus, based on our assumptions, a PIDR at this level does not appear to provide for the majority of claimants to be more likely to be over-compensated than under-compensated.
  - for all core claimant types there is also a relatively high likelihood (35%-50%) of significant under-compensation.
- A PIDR of +1.25% does not fully satisfy the principles across all core claimant types because it provides:
  - only the 40-year claimant with more than a 50% likelihood that they receive compensation that proves at least sufficient to meet their needs. This likelihood reduces to around 30% and 45% for the 20- and 60-year claimants respectively.

[1] Likelihoods may not add to 100% due to rounding

- the 40-year claimant with around 30% likelihood that they are significantly under-compensated. This likelihood increases to around 35% and 45% for the 20- and 60-year claimants respectively.
- a higher likelihood of significant under-compensation compared to significant over-compensation, albeit the likelihood of significant over-compensation is limited to around 20% or below, for all core claimant types.

- A PIDR of +1% meets most of the principles across the core claimant types, but has lower likelihoods of at least sufficient compensation and somewhat higher likelihoods of significant under-compensation compared to lower PIDRs. It provides:
  - a 50% or more likelihood of receiving compensation that proves at least sufficient to meet their needs for the 40-year and 60-year claimants. This likelihood reduces to 40% the 20-year claimant.
  - the 40-year claimant with around 20% likelihood that they are significantly under-compensated. This likelihood increases to around 25% and 35% for the 20- and 60-year claimants respectively.
  - 40- and 60-year claimants with a likelihood of significant over-compensation limited to around 30% or less. This likelihood reduces to less than 5% for the 20-year claimant.
  - 40-year claimants with a lower likelihood of significant under-compensation compared to significant over-compensation, but the 20-year and 60-year claimants with a higher likelihood of significant under-compensation compared to significant over-compensation.

- A PIDR of +0.75% meets most of the principles across the core claimant types, and provides:
  - the 40- and 60-year claimants with around 70% and 60% likelihood that they receive compensation that proves at least sufficient to meet their needs respectively. This likelihood reduces to just below 50% for the 20-year claimant.
  - the 40-year claimant with around 15% likelihood that they are significantly under-compensated. This likelihood increases to around 20% for the 20-year claimant and to around 30% for the 60-year claimant.
  - the 40- and 60-year claimants with a likelihood of significant over-compensation limited to around 35%. This likelihood reduces to around 5% for the 20-year claimant.

  - the 40- and 60-year claimants with a lower likelihood of significant under-compensation compared to significant over-compensation, but the 20-year claimants with a higher likelihood of significant under-compensation compared to significant over-compensation.

- A PIDR of +0.5% meets most of the principles across the core claimant types but with higher likelihood of significant over-compensation (over 40% for two of the three claimant types) when compared to higher PIDRs. It provides:

  - at least a 50% likelihood that all core claimant types receive compensation that proves at least sufficient to meet their needs. Specifically, around 75% likelihood for the 40-year claimant, 65% likelihood for the 60-year claimant, and 55% likelihood for the 20-year claimant.

  - the 40- and 20-year claimants with around 15% likelihood that they are significantly under-compensated. This likelihood increases to around 25% for the 60-year claimant.

  - the 40- and 60-year claimants with a likelihood of significant over-compensation of between 40% and 45%. This likelihood is around 5% for the 20-year claimant.

  - only the 20-year claimant with a higher likelihood of being significantly under-compensated compared to significantly over-compensated, but with the difference between the likelihoods being smaller than under a PIDR of 0.75%.

It will be for the Lord Chancellor to decide on the appropriate level and likelihoods of under- and over-compensation, taking into account the analysis as a whole.

Sensitivity analysis

Sensitivity analysis considering a wider group of claimants than the core claimant types suggests that the median net real return for these groups generally also falls in the range of +0.5% to +1.5% p.a. discussed above. A PIDR closer to the lower end of the range of +0.5% to +0.75% is required to provide at least 50% likelihood that all of these additional claimant types receive at least sufficient compensation. A key exception is for claimants with a significantly shorter term than 20 years. For the 10-year claimant modelled, the median net real return is around +0.3% p.a. However, for all PIDRs considered, this group of shorter-term claimants have a high likelihood of achieving at least 90% compensation.

Sensitivity analysis to quantify the impact of different plausible assumptions did not produce evidence that led to the need to consider a PIDR below +0.5%. However, the outcomes from lower PIDRs can be obtained from the GAD Report.

Summary of single rate advice

Setting the PIDR requires a judgement regarding the balance of risks highlighted above. We have considered the outcomes for claimants against the principles underpinning our assessment of the options for the PIDR, and these are summarised below:

	Core claimant type											
	20-year				40-year				60-year			
PIDR	Likelihood of achieving a compensation level of…											
	at least 100%	less than 90%	90-120%	more than 120%	at least 100%	less than 90%	90-120%	more than 120%	at least 100%	less than 90%	90-120%	more than 120%
0.50%	**55%**	17%	76%	7%	**76%**	13%	42%	45%	**64%**	25%	34%	41%
0.75%	**47%**	22%	74%	5%	**69%**	17%	45%	37%	**58%**	30%	37%	33%
1.00%	**40%**	27%	70%	3%	**63%**	22%	48%	30%	**50%**	36%	38%	26%
1.25%	**32%**	33%	65%	2%	**55%**	28%	50%	22%	**43%**	43%	38%	19%

Based on this analysis we conclude:

- A PIDR of +1.25% does not sufficiently meet the principles across the claimant universe.
- A PIDR of +1% satisfies the majority of principles but has somewhat higher likelihoods of significant under-compensation, and lower likelihoods of at least sufficient compensation compared to lower PIDRs.
- A PIDR of +0.75% satisfies the majority of principles.
- A PIDR of +0.5% satisfies the majority of principles and has lower likelihoods of significant under-compensation, but somewhat higher likelihoods of significant over-compensation compared to higher PIDRs.

The Lord Chancellor will need to consider this balance between sufficient, over- and under-compensation across different claimant types.

The analysis presented in this report should be used as an illustration of the risks that claimants might face, to help the Lord Chancellor's judgement in determining an appropriate PIDR. However, we draw attention to the uncertainties in the evidence and judgements we have made regarding assumptions about the future. The investment returns available to claimants, as well as the costs and expenses, will inevitably be different from those assumed in our analysis. We therefore emphasise that the analysis will not provide a calibration of a precise level of risk or claimant compensation. Notwithstanding this, based on our judgement as a Panel, we believe the approach we have taken and proposals we have made are suitable.

Advice on dual or multiple rates

We do not recommend a dual rate either by term or heads of loss, primarily because the potential benefits to claimants do not currently justify the additional complexity and expense it would introduce to the claim process.

Evidence across all stakeholder groups (including those acting in the interest of claimants) also indicated a preference for retention of a single rate, compared to a dual rate by either term or heads of loss. This is largely because of the expected negative impact on the claims process, as well as transition costs.

Unless there were to be a significant change to either stakeholder views or underlying claims features and expected market outcomes, the conclusion that the benefits of switching to dual or multiple rates are unlikely to outweigh the costs is likely to persist in future reviews of the PIDR.

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1. Introduction

1.1. The Civil Liability Act 2018 ('the CLA') describes the way in which the Personal Injury Discount Rate (PIDR) is to be set by the Lord Chancellor and sets out the requirement to consult an Expert Panel ('the Panel') and HM Treasury as part of this and subsequent reviews. To implement the initial review expeditiously, the CLA provided that only the Government Actuary would be consulted for the 2019 review. This review is therefore the first to involve the Panel. This report represents the Panel's advice to the Lord Chancellor.

1.2. This Panel was formed on 21 July 2023 to begin considering the next PIDR review, in preparation for the consultation by the Lord Chancellor, which commenced on 15 July 2024. The consultation process requires us to provide the Lord Chancellor with options for setting the PIDR, with varying degrees of confidence.

1.3. These options have been informed by members' expert knowledge and additional insight gained from the activities of the Panel. Further detail of the scope of the Panel's work is covered in Appendix A.

1.4. This report provides the information and analysis underlying the Panel's advice. The structure of the report is as follows:

- **Review background** – outlines the relevant background which influences how we fulfil our role.
- **The PIDR in practice** – discusses aspects of the personal injury claim process, which provide context for our considerations.
- **Evidence and analysis** – outlines the evidence and analysis on which we have based our advice.
- **Estimating claimants' financial outcomes** – considers the factors and assumptions that influence the median rates of returns for recipients of damages.
- **Allowing for uncertainty in setting the PIDR** – discusses the impact of economic uncertainty on the expected levels of compensation, alongside other uncertainties that impact on outcomes for claimants.
- **Analysis of dual or multiple rates** – discusses the considerations around the potential of having more than one PIDR.

- **Summary of advice** – sets out considerations for the Lord Chancellor and a summary of our advice.

Appendices cover the scope of the Panel's work, Terms of Reference, the letter of consultation from the Lord Chancellor, details of the Panel members and changes since the 2019 review. Key words and phrases as well as abbreviations used are defined in the Glossary.

2. Review background

2.1. The legal and governance framework for the PIDR review determines how the Panel should fulfil its remit. This section sets out the relevant background to the PIDR review, including the legal and governance framework associated with the PIDR, as well as the role of the Panel.

Role of the Personal Injury Discount Rate

2.2. In serious personal injury cases, claims for compensation cover impacts that are expected to last many years, potentially affecting the rest of the individual's life. The underlying principle of 'full (or 100%) compensation' was established in Wells v Wells[2]:

> "...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…".

2.3. The compensation provided can come in several forms, including:

- lump sums to cover claimants' future costs and losses (such as lost earnings);
- lump sums to deal with specific upfront needs, such as adaptations to a claimant's accommodation, or for costs and losses incurred prior to the award payment;
- lump sums to cover general damages; and
- Periodic Payment Orders (PPOs) to provide an income stream over a claimant's lifetime, or until expected retirement for loss of earnings.

2.4. In the remainder of this report, lump sum refers to the amount paid to an injured claimant to represent the present value of future losses, excluding any past losses, general damages, accommodation, PPOs and any other heads of loss not subject to the PIDR.

[2] Wells v Wells [1999] 1 AC 345
https://publications.parliament.uk/pa/ld199798/ldjudgmt/jd980716/page01.htm

2.5. In assessing the present value of future losses, the following are allowed for:

a. the period over which losses and costs are expected to emerge;

b. the assumed real rate of return that the claimant will earn on the lump sum award over that period, where the 'real rate of return' is defined as the investment return once costs such as tax and expenses have been accounted for and net of damage inflation.

2.6. This assumed real rate of return is referred to as the Personal Injury Discount Rate, or PIDR. A lower PIDR means that a lower rate of return net of expenses, tax and damage inflation is expected on a claimant's investments and therefore, all other things being equal, that a higher initial lump sum is required to meet the claimant's needs, and vice versa.

Legal and governance framework

2.7. The CLA requires the Lord Chancellor to set the PIDR with reference to the return that a claimant would reasonably expect to achieve if they invested in a diversified portfolio using an approach which involves:

a. more risk than a very low level of risk, but

b. less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.

2.8. In doing so, the Lord Chancellor is to have regard to the following when setting the PIDR:

a. the actual returns that are available to claimants

b. the actual investments made by claimants and

c. the appropriate allowance for tax, inflation and investment fees.

2.9. We interpret investment fees to also include the costs of financial advice, and we interpret inflation to mean damage inflation.

2.10. We understand that the intention of the CLA was in part to ensure the PIDR better reflected how claimants invest their awards in practice. As such, identifying the appropriate diversified portfolio(s) which meet the risk requirements of the CLA is a key area where we have sought evidence and broader information and applied judgement.

2.11. The Lord Chancellor must review the current PIDR of minus 0.25% set in July 2019 and determine whether it should be:

a. changed to a different rate, or

b. kept unchanged at the current rate

2.12. Given the requirement for the Lord Chancellor to consider the current rate, we have factored that into our considerations where appropriate.

2.13. In addition, the Lord Chancellor has the option of setting different PIDRs for different claim types (either by different heads of loss, or different expected terms of award), with the aim of improving the likelihood of different claimant groups achieving full compensation. We therefore also consider the implications of dual or multiple rates in our advice.

Role of the Panel

2.14. The role and responsibilities of the Panel are set out in our Terms of Reference in Appendix B. We are required to provide advice in relation to the returns (or range of returns) that it is reasonable to expect the recipients of relevant damages to achieve, and the risk associated with these. We are also required to consider evidence on dual and multiple rates.

2.15. The Panel must be chaired by the Government Actuary and contain four further members with specific expert experience. The Panel members for this review are:

- Fiona Dunsire – Government Actuary (previously Martin Clarke up to 31 October 2023)
- Charl Cronje – member with experience as an actuary
- Rebecca Driver – member with experience as an economist
- Donald Taylor – member with experience of managing investments
- Ed Tomlinson – member with experience in consumer matters as relating to investment.

More details on each of the Panel members are set out in Appendix D.

3. The PIDR in practice

3.1. We have sought to understand the full context of claimant circumstances and how the PIDR is used in practice to inform our advice to the Lord Chancellor. This is because we are mindful that the lived experience of claimants and the potentially life-changing circumstances involved in serious injury cases can influence outcomes. We provide a summary in this chapter of aspects which form the backdrop to our advice, and we believe this will be useful for the Lord Chancellor and other stakeholders.

Parties affected by PIDR claims

3.2. There are three main groups of stakeholders who will be affected by how the PIDR is set: claimants; defendants and their insurers; and individuals as taxpayers or purchasers of insurance.

3.3. Claimants in these cases are individuals who have suffered serious injuries. They may no longer be able to work, and therefore may have years of lost future earnings, and also may need significant long-term care. The costs of care and equipment on an ongoing basis can also be very significant.

3.4. The evidence submitted for this review demonstrated that the types of claimants and their circumstances can vary significantly. Claimants include, but are not limited to, those who have suffered serious injuries at birth or through other medical negligence, those who have suffered serious workplace accidents, or those who have been involved in serious road traffic accidents.

3.5. Defendants in serious personal injury cases also vary. In general, the defendant in a serious personal injury claim is the party that is responsible for any injury or illness. Types of defendants can include, amongst others, drivers, cyclists or motorcyclists (in road traffic accident claims); employers or equipment manufacturers (in workplace accident and industrial illness claims); local authorities (in claims about accidents in public places caused for example by poor maintenance); Government departments (such as in military injury claims); or the NHS (in relation to clinical negligence).

3.6. In many cases, however, a claim will not be brought against the person or organisation that is directly responsible for the accident, but rather their insurer. Cases of clinical negligence involving the NHS in England and Wales are indemnified by the UK Government, through NHS Resolution.

3.7. Finally, individuals also have a stake in the outcome of personal injury claims either as the purchasers of insurance, as insurance premiums reflect the expected cost of claims and reserving, or as taxpayers. The impact on taxpayers is twofold. Where the NHS or other government bodies are the defendant, then claims costs are ultimately covered by taxpayers. In cases where compensation is inadequate in practice, it is also likely that the taxpayer will need to provide support through the benefit system and social services to claimants who are no longer able to fund their cost of care.

3.8. The principle of full compensation means that it is the impact on claimants that underpin a decision on the PIDR. In formulating our advice to the Lord Chancellor therefore we have focused solely on the impact of different PIDR options on claimants in line with our Terms of Reference, rather than also considering the impact on other stakeholders.

Claim process

3.9. We consider it is important for us to be suitably informed on the key aspects of the claim process, as these have a bearing on what it is reasonable for the Panel to assume when considering suitable PIDRs. This is also particularly important in providing advice about the potential costs and benefits of a single versus dual or multiple rate approach, discussed further in Section 7, as any change in approach would have an impact on the claims process.

3.10. Our understanding is that, once evidence is gathered on a claimant's injuries or illness, together with their impact and their future implications, the claim is valued using identified heads of loss. Multi-year elements are valued using the multipliers from the Ogden Tables appropriate to the PIDR in force. These claim values are set out in a Schedule of Loss.

3.11. A proposal on compensation can be made by the defendant or by the claimant, and both sides can make multiple offers during the negotiation. The evidence we have reviewed demonstrates that, although some personal injury claims are decided in court, most claims conclude with a settlement between the parties, without the need to go to court. Nevertheless, claims can still take years to conclude because of the complexities involved.

3.12. Many respondents to both the 2023 and 2024 Calls for Evidence highlighted that, as a result of the prevalence of out-of-court settlements, there is often no clear documentation of the agreed allocations of the final settlement amount across the various heads of loss, nor of agreed terms of each head of loss. Instead, agreement is often reached on the basis of aggregate amounts that are acceptable to both parties.

3.13. When a settlement is reached, compensation is paid, which can be as a lump sum or as a lump sum in combination with a PPO.

3.14. The Panel understand that, for the purpose of our advice, we must assume damages are paid solely in the form of a lump sum, rather than as a combination of lump sum and PPO. However, we note that PPO availability and take-up influences the range of claimants that receive a lump sum and the size of those lump sums.

3.15. Where a claimant lacks capacity to manage their financial affairs, an application can be made to the Court of Protection to appoint a financial deputy to manage their money. As a result, we assume that all claimants, including the most vulnerable, have access to appropriate advice and either have the capacity or the assistance necessary to consider and act on that advice.

Calculating full compensation

3.16. The application of the PIDR is just one factor in the legal exercise of providing full compensation to claimants. The evidence presented for this review demonstrates that this exercise is not an exact science, recognising that the future is uncertain and that a claimant may ultimately need more or less money to meet all of their needs.

3.17. Basing the settlement on an estimate of a claimant's future needs at the time of the settlement means there is a risk that a claimant's future needs differ from those that were expected. For example, either more or less care may be needed than agreed, or different aids and equipment may become available that better meet a claimant's needs than envisaged at settlement. This risk is implicitly accepted by the claimant as part of the settlement, as only in rare cases would a future revision to the settlement be made. As such, it is recognised by all parties that it is not possible to know with any great degree of certainty whether a given level of compensation will be sufficient to meet a claimant's needs many years into the future.

3.18. Indeed, even if needs were precisely known, it would still not be feasible to assess whether a claimant had been 100% compensated in practice, because of a variety of uncertainties including, amongst other things, the claimant's longevity and the return that will be earned in practice on the lump sum.

3.19. The lump sum element will typically reflect expected costs over a claimant's lifetime, and therefore relies on an estimate of the claimant's life expectancy or, in the case of lost earnings, the period until their expected retirement age. This is allowed for by using multipliers in the Ogden Tables, whereby the relevant multiplier is applied to the annual loss in current monetary amounts, based on the assumed term, to calculate the lump sum amount.

3.20. The multipliers in the Ogden Tables are based on "normal" life expectancy predictions, which typically provide a starting point for an assessment of a claimant's life expectancy. However, the court or parties may agree to deviate from this figure, if there is evidence in an individual case that the claimant can be expected to experience a significantly different lifespan. In general, we understand claims do not settle for a life expectancy longer than normal.

3.21. Claimants with a lump sum are therefore exposed to longevity risks, in that they could live longer than is allowed for in the settlement. Where available, PPOs can provide greater certainty to a claimant, and hence remove some investment and longevity risk, because payments are made over the entire course of their life. Nonetheless, for the purpose of our advice on the PIDR, we are required to focus on lump sum settlements, and it is not possible to know whether a claimant will live for longer or shorter than the life expectancy allowed for in the settlement.

3.22. Although the Panel recognises that longevity risk is a key concern for claimants, we do not consider an allowance for it should be made through an adjustment to the PIDR, given the requirement in the CLA to assume the lump sum is exhausted at the end of the assumed period.

4. Evidence and analysis

4.1. In formulating our advice, we have drawn on a range of quantitative and qualitative evidence via Calls for Evidence, further discussions with stakeholders including requests for data, and from commissioned analysis undertaken by the Government Actuary's Department.

4.2. As well as the information which formed the basis for the 2019 PIDR review, we have been provided with information from two Calls for Evidence, which each had responses from a wide range of stakeholders:

a. A Call for Evidence on 'Exploring the option of a dual/multiple rate' was issued by the Ministry of Justice (MoJ) in early 2023 and the responses published[3] in September 2023.

This Call for Evidence was issued prior to the formation of the Panel, and was an outcome of the 2019 PIDR review, which looked at the potential impacts of a dual rate on claimant outcomes.

The then Lord Chancellor considered that this was a potentially worthwhile option, but he also felt that more work was required to identify the appropriate structure and practical impact of introducing a dual or multiple PIDR. He therefore committed to seeking additional views and evidence ahead of the current review of the rate.

b. A Call for Evidence, issued by MoJ in January 2024 ('the CfE'), to seek information and up-to-date data on relevant factors for this review, including how those factors may have changed since the evidence collected in 2018 for the 2019 PIDR review. This also sought evidence around the range of claimant characteristics, to allow us to consider the impact of the PIDR on different types of claimants in forming our advice. The responses will be published[4] in December 2024.

[3] Ministry of Justice (2023) Personal Injury Discount Rate: Exploring the option of a dual/multiple rate. Available at: https://www.gov.uk/government/consultations/personal-injury-discount-rate-exploring-the-option-of-a-dualmultiple-rate

[4] Ministry of Justice (2024) Setting the Personal Injury Discount Rate. Available at: https://www.gov.uk/government/calls-for-evidence/setting-the-personal-injury-discount-rate

4.3. We are also aware that some organisations may have data which is useful to support certain elements of the 2024 PIDR review, but may not have been comfortable responding publicly, or may have had commercial reasons limiting their responses. With the support of MoJ, we have therefore undertaken targeted discussion with these organisations to expand our data sources and support gaps in the evidence base, where appropriate.

4.4. We also recognise the limitations of the data that are readily available to support this review. For example, there is no single data source giving the size and number of claims, together with the life expectancy of claimants, because defendants do not hold this information in a consistent way. This makes it hard to form a definitive view of the distribution of claimants. Similarly, claimant advisers and claimant lawyers do not retain all the data we would ideally like to have access to, especially where they do not need to collate, store and manage it as part of their ongoing business needs. Retaining data that are not of direct benefit to clients, or used for client management, would have cost and potentially data protection implications.

4.5. We commissioned GAD to undertake analysis to inform the assumptions underpinning our advice and to quantify outcomes for claimants with various different characteristics. This was to help us assess whether claimants are likely to have at least sufficient compensation to meet their needs under different rates for the PIDR, and the likelihood of being over- or under-compensated. This analysis supports our advice. All commissioned analysis was instructed and scoped out by the Panel, including the method by which all conclusions were reached. The GAD Analytical Report is therefore published alongside this report.

4.6. We have sought to establish assumptions for the analysis that would, in our view, be consistent with claimant characteristics. We have not allowed for any margin for prudence in the assumptions.

4.7. The assumptions are designed to be internally consistent, to the extent that an assumption for one factor influences the assumption for others, and they should be considered as a whole.

4.8. Our understanding of the CLA is that claimants should be more likely to be over-compensated than under-compensated and these assumptions are therefore the starting point for estimating claimants' financial outcomes and allowing for uncertainty when setting the PIDR, as discussed in Sections 5 and 6.

4.9. We have also tested the sensitivity of our advice to the assumptions made and checked that it is reasonable when considering changes to the market and external environment since the last review.

5. Estimating claimants' financial outcomes

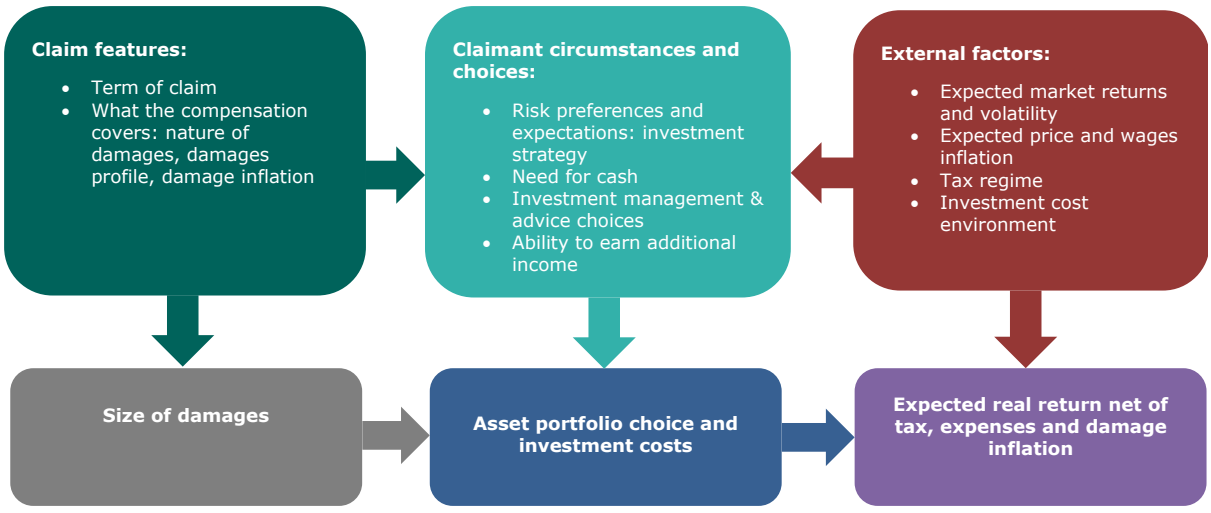
5.1. In forming our advice to the Lord Chancellor, we need to consider the factors that influence the rate of return a recipient of damages could reasonably be expected to achieve. In our experience, and supported by the evidence gathered for this review, claimants can face very different circumstances. We have therefore considered outcomes for three core claimant types designed to cover a range of key claimant characteristics.

5.2. In Section 6, we assess the sensitivity of outcomes to key factors and the assumptions adopted in forming our advice. We also consider additional claimant types that fall outside of the main claimant groups considered in the core analysis. These additional analyses are intended to assist the Lord Chancellor in considering how to set the PIDR.

Factors determining claimant outcomes

5.3. The primary justification for regular reviews of the PIDR is that economic conditions change and therefore expectations of future investment returns, net of tax, expenses and damage inflation, also change. However, to understand claimant outcomes, we have made assumptions about all the factors that influence the claim, including claim features, claimants' circumstances and choices, and external factors. These are summarised below:

Figure 1 Factors influencing claims



5.4. In the sub-sections below we discuss these factors in turn and how the evidence has been interpreted to define core and additional claimant characteristics and to model outcomes for claimants. More background and detailed information on the approach to modelling claimant outcomes is covered in the GAD Analytical Report.

Claim features

Term of damages

5.5. The term of the damages is the period over which a claimant's losses are expected to extend and over which their lump sum is expected to be invested. The impact of term on investment strategy choices, tax and expenses is discussed in the relevant sections below.

5.6. Personal injury claimants each have their own unique circumstances. For example, one claimant may be being compensated for partial loss of earnings due to an accident at work, whilst another might face complex care needs for the rest of their life due to clinical negligence at birth. The term will therefore vary depending on the nature of their injury and could be for a defined period or the rest of their life. The term used in the calculation of the lump sum is based on the claimant's age at time of settlement, adjusted for any medical evidence on impairment or limited life expectancy.

5.7. Evidence supports an average term of around 40 years with the vast majority of claimants having a term between 20 and 60 years. The data we have considered suggests approximately three-quarters of claimants have a term of greater than 30 years. In our view it is reasonable to consider claimant types with terms of 20, 40 and 60 years.

5.8. We recognise that longer-term claimants are most impacted by the PIDR, both in absolute and percentage terms, and we have taken this into consideration in forming our advice.

5.9. Claimants with very short investment periods, for example 10 years, may be at greater risk of receiving insufficient compensation under a single discount rate. This is primarily because they would typically take a more cautious investment approach than longer-term claimants, which will likely carry lower average expected returns.

5.10. To illustrate these risks, we include analysis of a claimant with a 10 year term in Section 7. We define them as 'the 10-year claimant' and assume that (with the exception of the term and cash reserve portfolio percentage), they have the same features as 'the 20-year claimant' as set out below. However, it should be noted that claimants with very short investment periods represent a relatively small proportion of the total claimant universe, and are least impacted by the PIDR as a percentage of their total lump sum. This is because the longer the assumed term, the greater the proportion of damages that are expected to be met through investment returns, as opposed to the lump sum itself.

Nature of damages

5.11. When considering appropriate assumptions for the nature of damages we focused on evidence around the breakdown of claims by heads of loss. This informs our assumptions on damage inflation and the profile of the damages. For example, heads of loss that are linked to earnings (either compensation for loss of earnings or to cover the cost of carers) will have a more material impact on the required rate of return than those linked to price inflation, as wage inflation is typically higher than price inflation.

Damage profile

5.12. Claimants will typically have a range of different needs which their award is designed to meet over time. Some of these will be regular ongoing costs (such as care costs), others will be damages which extend only for a period of time (such as loss of earnings over their future working life). Some may be expected to occur only every few years (such as replacement of medical equipment) and some may change over time, to either increase or decrease as claimants age and their condition and circumstances evolve. These damages are all captured under different heads of loss categories as current annual amounts.

5.13. The evidence suggests that the profile of damages (that is, changes from year to year due to factors other than inflation) is specific to each individual. For simplicity, we have therefore assumed annual damage amounts are level in real terms (that is, before allowing for damage inflation) over the term of investment. We have tested the sensitivity of outcomes for claimants to this assumption and concluded that it is not material to our advice.

Damage inflation

5.14. As damage payments are expected to be made many years into the future, we also need an appropriate assumption for damage inflation. The level of damage inflation will be determined by the different heads of loss making up a claim.

5.15. We have reviewed all the evidence and information provided for this review and concluded that claimants are broadly exposed to price inflation, which we have taken as measured by the Consumer Price Index (CPI) and to earnings inflation.

5.16. We considered evidence that there are elements of damages which may increase at higher rates than CPI and earnings indices. In particular, that future care worker earnings may be subject to higher inflationary pressures than general earnings, through increased demand for these services due to the ageing population as well as supply-side constraints. In addition, there is some evidence that the medical and health components of CPI have experienced higher rates of inflation than the prices of general goods and services. There was not sufficiently robust evidence on this to change our view that CPI and general earnings inflation were reasonable rates for the key components of damage inflation.

5.17. Taking into account the responses to the CfE and the advice we have received from GAD, we judge an appropriate long-term assumption for general earnings inflation to be in the range 1.25% p.a. to 1.5% p.a. above CPI.

5.18. The evidence suggests earnings related damages are 65%-85% of claimants' overall lump sum damages. Thus, considering the ranges above and the uncertainties in these figures, we have assumed that all claimants experience damage inflation of CPI+1% p.a.

Size of damages

5.19. When considering appropriate assumptions about the sizes of the damages we focused on evidence around the size of claimant lump sum awards as opposed to annual damage payments. This is the most readily available data source which contains the information required to summarise the impact on the required rate of return. The lump sum size is impacted by the term of the damages, with longer terms (all else being equal) being associated with larger lump sums. The size of the lump sum will also have a direct impact on the tax and expenses paid by claimants, as discussed in the relevant sections below.

5.20. The evidence shows that the distribution of lump sum awards is positively skewed by size, meaning that there are a large number of relatively small awards paid to claimants, and a smaller number of large and very large lump sum awards. We would typically expect that a greater proportion of larger lump sum awards would be for claimants with longer investment horizons as they include more years of expected damage payments. Because of the skewed distribution, the average lump sum size will not necessarily be representative of the universe of claimants most impacted by the PIDR.

5.21. The average lump sum size appears to be in the range £500k to £750k, but with a significant number of longer-term claims in the range £1m to £5m, and with very large lump sums up to £10m or more also being feasible. In general, larger lump sums are more likely to be associated with more catastrophic damages and higher care needs.

5.22. Therefore, rather than focusing the analysis only on the average lump sum size, we have considered outcomes for lump sum sizes of £500k to £5m, with £10m included for additional sensitivity analysis. The analysis has tested the sensitivity of outcomes for claimants with lump sum sizes below £500k and concluded that it is not material to our advice.

5.23. For the purposes of defining the core claimant types, we focused on the three subsets of the total claimant universe: ‘the 20-year claimant’ being a claimant with a 20 year term who receives a £500k lump sum; ‘the 40-year claimant’ being a claimant with a 40 year term who receives a £1m lump sum; and ‘the 60-year claimant’ being a claimant with a 60 year term who receives a £5m lump sum. These investment terms and lump sum sizes were selected to enable us to model outcomes for a significant cross section of the claimant universe. They impact on a number of other key factors, for which additional internally consistent and reasonable assumptions have also been made.

Claimant circumstances and choices

5.24. On receipt of a lump sum, there are decisions made by or on the behalf of claimants that influence the investment return, through:

- Their **risk preferences and the need for cash**, which defines the **investment strategy** (what asset classes claimants invest in to meet their needs) and how these change with time, together with the size of any cash reserve.

- Choices on **investment management approach and financial advice**, such as whether claimants invest using an active or passive investment approach and the type of advice they receive, impacting on the level of expenses incurred.

- The **tax management approach**, impacting on the level of tax incurred.
- Combined, these decisions determine the **asset portfolio** chosen, and therefore the expected returns, and the levels of tax and expenses claimants experience.

5.25. In addition, a claimant's tax costs will also be impacted by their own circumstances, including any additional income they have over and above the income from their damages award.

5.26. In the remainder of this section, we summarise our conclusions on the appropriate way to allow for these claimant circumstances and choices when considering the assumed rate of return.

Choice of investment strategy

5.27. When considering appropriate investment strategies, we focused on evidence regarding actual investments made, alongside utilising the Panel's expertise on what a suitable portfolio would be. In doing so we are required to take into account the legislative requirements and must assume:

- The claimant is 'properly advised on the investment of the relevant damages';
- The claimant holds 'a diversified portfolio of investments';
- The claimant takes 'an approach that involves more risk than a very low level of risk, but less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.'

The assumed portfolio must also 'have regard to the actual investments made by investors of relevant damages.'

5.28. We have also recognised that there is some tension between the assumptions required by the legislation, and there is inevitably a need to balance the evidence provided and make a judgement on appropriate portfolios. For example, there is consistent evidence that claimants hold a substantial cash reserve, to ensure they have funds available to meet their needs for several years. Thus, the asset portfolio chosen by claimants (or their advisers) may be less diversified or efficient than one from a theoretical investment perspective which does not consider claimants' needs for cash.

5.29. Claimants invest their lump sums over a long investment period, and their investment strategy may change over time. However, for simplicity we assume a static asset portfolio over the full investment period, which is designed to represent an average portfolio held over a claimant's lifetime.

5.30. For the purposes of this analysis, we have defined risk (as referred to in the legislation) as the chance that the claimant's funds are exhausted before the end of the assumed investment period (that is, the term over which their damages are expected to extend). In relation to risk preferences, our assumption is that as the investment horizon increases, claimants can be expected to include a higher proportion of risky assets within their portfolios. This reflects the fact that longer horizons allow portfolios more time to recover in the event of negative market outcomes, and the potential for higher returns helps protect claimants from the risk of running out of money (for example, because of higher-than-expected earnings inflation).

5.31. Based on the evidence supplied in this area, which was largely from advisers, we have defined three invested portfolio types shown in Table 5.1 below: Cautious, Central and Less-cautious, which sit alongside a cash reserve to create a range of suitable asset portfolios.

Table 5.1 Invested portfolio asset allocation

	Invested portfolio (excluding cash reserve)		
Asset class	**Cautious**	**Central**	**Less cautious**
Lower risk	**60.0%**	**50.0%**	**40.0%**
Cash	2.5%	2.5%	2.5%
Gilts	17.25%	14.25%	11.25%
Index-linked gilts	17.25%	14.25%	11.25%
Corporate bonds	23.0%	19.0%	15.0%
Higher risk	**40.0%**	**50.0%**	**60.0%**
UK equity	16.0%	20.0%	24.0%
Overseas equity	16.0%	20.0%	24.0%
Diversifiers	8.0%	10.0%	12.0%

5.32. These portfolios reflect the broad range of splits between lower- and higher-risk asset classes referenced in the evidence. Given that the evidence in this area provided a wide range of suitable approaches highly dependent on claimants' and advisers' preferences, the splits adopted were steered by the expertise of the Panel.

5.33. In particular, we have allowed for a cash allocation towards the lower end of the range of the invested portfolios covered by the evidence. This reflects the fact that the evidence indicates claimants separately hold a large cash reserve, and therefore a cash allocation in the invested portfolio should only be required to provide sufficient portfolio liquidity for trading activities. As discussed further below, we have assumed a passive investment approach, and a lower cash allocation is consistent with this approach. More detail on the rationale for these allocations is set out in the GAD Analytical Report.

5.34. For the reasons set out above, we consider that it is appropriate to assume that claimants with longer investment horizons are able to take on more investment risk. Therefore, in defining the core claimant types, we assume that the 20-year claimant will invest in the cautious portfolio, the 40-year claimant will invest in the central portfolio and the 60-year claimant will invest in the less-cautious portfolio. However, we test the sensitivity of outcomes to these assumptions as part of the sensitivity analysis.

5.35. Evidence suggests that cash is held to cover several years of damages. We have therefore allowed for cash reserves separate from the invested portfolio equivalent to 3 years of damage payments for 20-, 40- and 60-year investment periods. This is calculated to be broadly equivalent to the cash reserve being on average 30%, 15% and 10% of the overall portfolios respectively, based on the analysis within the GAD analytical report.

Table 5.2 Cash reserve for core claimants

	Core claimant type		
	20-year	40-year	60-year
Cash reserve	**30.0%**	**15.0%**	**10.0%**

Choice of asset portfolio

5.36. The cash reserve and invested portfolio assumptions combine to give us a range of asset portfolios dependent on the assumed level of risk and the term of investment.

5.37. The three portfolios utilised in the analysis of the core claimants, together with the resulting median return above inflation (CPI) are set out in Table 5.3 below. These median returns have been calculated based on simulations from the two economic models used by GAD in their analysis.

Table 5.3 Portfolio asset allocation and median returns

Asset class	Asset portfolio (core claimant type)		
	Cautious (20-year)	Central (40-year)	Less cautious (60-year)
Lower risk / cash	**72.0%**	**57.5%**	**46.0%**
Cash reserve	**30.0%**	**15.0%**	**10.0%**
Lower risk	**42.0%**	**42.5%**	**36.0%**
Cash	1.8%	2.1%	2.3%
Gilts	12.1%	12.1%	10.1%
Index-linked gilts	12.1%	12.1%	10.1%
Corporate bonds	16.1%	16.2%	13.5%
Higher risk	**28.0%**	**42.5%**	**54.0%**
UK equity	11.2%	17.0%	21.6%
Overseas equity	11.2%	17.0%	21.6%
Diversifiers	5.6%	8.5%	10.8%
Median return net of CPI p.a.	**2.9%**	**3.5%**	**3.8%**

5.38. We consider that these portfolios reflect a reasonable range of options for a suitably low-risk investor based on the evidence we have reviewed. The portfolio returns are higher than the returns we would expect for a lowest risk investor, whom we interpret to be likely to invest entirely in cash and/or index-linked government bonds.

5.39. By contrast, an individual investor with different financial aims might invest in a range of return-seeking assets such as equities or diversified growth funds. We would therefore expect the portfolios above to have a lower level of both risk and return compared to these types of assets.

5.40. A ‘ordinary’ prudent investor is more difficult to define, as risk is subjective and depends on investor objectives and preferences. We have tested the portfolios above against a number of benchmarks, including the approaches used by large multi-employer defined contribution pension schemes. These are not directly comparable, as personal injury claimants require money now rather than from retirement age and are likely to have more uncertain costs and inflationary pressures. They do however share some characteristics, in that they are long-term, properly advised investors, ultimately seeking to deliver a long-term income stream.

5.41. In considering defined contribution portfolios, we therefore focused on the lower-risk allocations which are typically used as members approach retirement, which would be more consistent with claimant needs. We are satisfied that all the portfolios considered are suitable, taking into account the requirements of the CLA.

Investment management approach and advice choices

5.42. The investment management approach used when investing a claimant’s lump sum, together with the advice they receive will influence investment expenses. We recognise that different claimants take different approaches when investing their lump sums, but also that is it important to be internally consistent when considering the likely returns and costs of a particular investment approach.

5.43. In line with the requirements of the CLA, we assume that all claimants receive financial advice. Part of the advice relating to the most appropriate investment strategy to meet their needs and risk preferences will cover the preferred investment management approach. Claimants can choose to invest using a passive or active approach and we acknowledge that both approaches have merit and are used in practice. In general, the investment management costs for a passive approach will be lower than those for an active approach.

5.44. Where a claimant invests their lump sum using discretionary fund management, this combines financial advice and underlying investment management and typically results in the use of an active investment strategy. This means regular (e.g. weekly, monthly or quarterly) changes to the invested portfolio through active asset allocation reflecting changes in the market environment, and which aims to add value relative to a given risk appetite over time.

5.45. Where a claimant invests their lump sum using a financial advisor, while an active approach is still possible, it is common for this to result in a more passive investment strategy. This means an unchanging long-term investment objective, which results in an asset portfolio which may change over time but would not be regularly updated to react to changing market or economic circumstances. Passive implementation uses underlying investments which are designed to track market benchmarks, rather than to seek outperformance through stock selection.

5.46. Under the core assumptions underpinning the Panel's advice, claimants are assumed to invest in a static asset portfolio, which can be interpreted to represent an average portfolio held over a claimant's lifetime. Consistent with this assumption, when considering the corresponding expenses, we assume that claimants adopt a passive investment approach to the extent possible.

5.47. We recognise that, where active management is adopted, investors are expecting this to deliver a higher investment return, either through seeking higher returns directly or by managing downside risks to boost average returns. Furthermore, active investors expect that these higher returns will outweigh higher investment expenses relative to a passive approach. However, such an outcome cannot be counted on in advance. Therefore, for the purpose of our advice on the PIDR, we have assumed that any additional returns from active management will be broadly offset by the additional investment expenses, meaning that the net returns available from active and passive investment strategies (after allowing for the differential in investment expenses), will be similar. Accordingly, in the analysis that we have requested from GAD, we have instructed them to perform modelling based on a passive investment approach.

5.48. Some respondents to the CfE stated that active management is often used to reduce risk rather than seek higher returns, and thus that the additional costs should be explicitly considered in setting the rate. However, we believe this is still consistent with the principle above. Adopting strategies to reduce risk should result in higher returns than otherwise in the less favourable economic scenarios, contributing to higher returns over time.

5.49. We have therefore focused on providing a range of appropriate expense assumptions that are consistent with a passive investment approach for an advised claimant.

Ability to earn additional income

5.50. One of the factors that will determine claimant outcomes is the extent to which a claimant can be expected to continue working and earn additional income during the remainder of their working life. This is because the ability to earn additional income has a direct impact on the likely net return a claimant can achieve, as it will increase the tax on any income from the invested lump sum.

5.51. In general, we have assumed that larger awards are associated with more catastrophic injuries that would reduce a claimant's ability to earn additional income. We have therefore assumed that smaller lump sums will be associated with claimants that that are relatively more likely to be able to earn other income. In such cases, for simplicity we assume that such income will be in line with UK median earnings. Therefore, in defining the core claimant types, we assume that the 20-year claimant will have £30k of additional annual income and the 40-year and 60-year claimants will have £7k of additional annual income. However, we also requested that GAD undertake some sensitivity analysis, in order to assess the robustness of our analysis to this assumption.

Tax management approach

5.52. The tax management approach is the extent to which a claimant can manage the tax they pay though tax-free allowances and investing through vehicles that reduce or eliminate tax on income or capital gains from investments. We recognise that different claimants take different approaches when investing their lump sums and that tax is part of that consideration. Also, not all tax management approaches are available to, or suitable for, all claimants.

5.53. Evidence provided suggests that alongside the use of personal allowances, the size of which will depend on a claimant's other income and level of savings, ISAs are the main tool through which claimants can manage their tax exposure. It is noted that the use of a personal injury trust would mean that ISAs could not be utilised. However, it is reasonable to assume claimants adopt this approach only if the benefits of doing so outweigh this disadvantage.

5.54. It is also noted that claimants are typically advised not to put settlements into joint names even though that would increase the ISA allowance available or have other potential tax benefits, because there are risks associated with a claimant not having sole ownership over the settlement.

5.55. Based on the information available, it is our judgement that it is reasonable to assume claimants do use tax efficient investment vehicles such as ISAs to the maximum extent possible to reduce tax, but that more sophisticated approaches to facilitate tax planning are only likely to be used by a small group of claimants with larger lump sum awards. The impact of this is discussed in the tax regime section below.

Summary of core claimant characteristics

5.56. In our experience, and supported by the evidence gathered for this review, claimants have a wide range of different characteristics and attempting to model the whole claimant universe would not be feasible.

5.57. Rather, we have considered the analysis of outcomes for three core claimant types designed to cover key claimant characteristics.

5.58. Table 5.4 below summarises the key claim features and claimant choices defining these core claimant types. Unless otherwise stated, all references to claimants by term in this report relate to the overall characteristics of these core claimant types.

Table 5.4 Summary of core claimant type characteristics

	Core claimant type		
	20-year	**40-year**	**60-year**
Investment term	20 years	40 years	60 years
Investment strategy	Cautious	Central	Less cautious
Lump sum size	£500k	£1m	£5m
Other taxable income p.a.	£30k	£7k	£7k

External factors

5.59. External factors that impact claimant choices that have a material impact on the required rate of return are the tax regime and investment cost environment. We have based our assumptions and analysis on the tax regime and investment cost environment in place at the time of this report.

5.60. In addition, the PIDR also needs to reflect expected economic and market conditions, which determine expected investment returns. The median returns net of CPI shown in Table 5.3 reflect the current market expectations over the relevant terms. These are based on economic simulations as at 31 March 2024 and, as explored further in the sensitivities in the GAD Analytical Report, we believe analysis at this date is appropriate for setting the PIDR for the current review period.

5.61. The analysis in Appendix E shows that changes in market conditions since the last review in 2019 account for the largest component of the changes in median net real returns.

Tax regime

5.62. A claimant investing their damage award will be subject to tax on their income and capital gains, reducing their net investment return, and thus an assumption of the annual tax drag is required.

5.63. In line with convention, our analysis is based on the tax regime in force at the time of writing this report.

5.64. In order to assess the expected tax a claimant will pay, we have focused on how the tax regime interacts with the decisions made on tax management and claim features discussed above. In doing so we recognise that actual tax positions will differ significantly from one individual to another. The appropriate allowance for tax is complex and even more dependent on each claimant's unique circumstance than the other assumptions. Indeed, even for an individual claimant their tax position is likely to change over the expected term of their damages.

5.65. The tax payable will depend on the size of damages, the term over which they are invested, the level of investment returns achieved, the use of tax efficient investments and the amount of other income that a claimant may have.

5.66. There was limited evidence provided on tax in the CfE. Some respondents provided high level tax calculations, but no one was able to provide sufficient evidence to fully inform an overall tax assumption.

5.67. We therefore commissioned GAD to assess the tax implications for claimants. Based on that, we assume a tax drag in the range 0.2% to 0.3% p.a. for most claimants, but also recognise that tax is highly personal. Those with very large awards could experience a tax drag of over 1% p.a., although again this could vary depending on their use of more sophisticated tax efficient vehicles. These sensitivities were explored in the analysis commissioned from GAD.

Investment cost environment

5.68. A claimant investing their lump sum will be subject to investment fees, reducing their net investment return. These are influenced by the choice of asset portfolio and investment management approach, and the size of lump sum award. They arise primarily in three areas: financial advice, fund management, and other costs, primarily investment platform fees. We considered each of these elements separately to assess the overall expected expenses.

5.69. In providing advice on the appropriate assumption for investment fees, we have considered all of the evidence and additional information provided for this review. Although this was broadly consistent in many places, it also highlighted a wide range of possible expense levels, with the differences primarily due to the assumed investment approach, and the lump sum size.

5.70. As set out above, we have assumed a passive approach to investment management. Some respondents to the CfE suggested that adopting passive investment management means that claimants do not need financial advice on an ongoing basis. We have considered the evidence and judge that financial advice is required by all claimants, albeit that the nature of that advice is likely to be more limited on an ongoing basis under a passive approach. We have reflected this in the assumed expenses.

5.71. Responses to the CfE noted that whether claimants would typically pay VAT on their financial adviser costs would depend on the specific circumstances. We have included this in the sensitivity analysis alongside other uncertainties in the level of expenses that claimants face.

5.72. We received evidence that the cash reserves that are typically held on an ongoing basis do not attract additional advice or management fees and thus have assumed no expense on this element of a claimant's portfolio. Since the size of cash reserve varies by term, this means that all else being equal portfolios with higher cash reserves will experience lower investment management expenses.

5.73. We also considered the evidence that investment fees, when expressed as an annual percentage of the lump sum, reduce as lump sum fund sizes increase and have reflected this in the assumptions. Taking into account all of these factors, we have sought to identify average costs for claimants for each element of expenses, reflecting our judgement that claimants will be in no better or worse position than an average investor to achieve cost reductions.

Table 5.5 Assumed investment fees

Component	Ongoing charge p.a.	Notes
Financial advice fee	0.25% to 0.75% of invested portfolio	The top end for smaller claims and bottom end for larger claims.
Fund manager fee	0.25% of invested portfolio	Very low fees are possible in passive funds.
Platform fee	0.10% to 0.30% of invested portfolio	Almost nil for the largest funds, but higher for smaller funds. Over the claimant's lifetime costs as a percentage of the invested portfolio will increase.

Median net real returns for core claimants

5.74. Given the range of claimant characteristics identified, we judge it appropriate to focus our advice around three 'core' claimant types that are expected to reflect key claimant characteristics within the claimant universe. For each of these claimant types, we have established internally consistent assumptions for the factors outlined in this section. Appendix E provides a summary of the key factors which have changed since the 2019 review for a 40-year claimant.

5.75. Using these assumptions, the median net real return is calculated as follows and is summarised for each claimant type in Table 5.6 below:

Median net real return = Median return – Expenses – Tax – Damage inflation

Table 5.6 Assumptions and median net real returns for core claimant types

Core claimant type	Median return p.a. (A)	Expenses p.a. (B)	Tax p.a. (C)	Damage inflation p.a. (D)	Net real return p.a. (A – B – C – D)
20-year	CPI+2.9%	0.9%	0.3%	CPI+1.0%	**0.7%**
40-year	CPI+3.5%	0.9%	0.2%	CPI+1.0%	**1.4%**
60-year	CPI+3.8%	0.6%	1.2%	CPI+1.0%	**1.0%**

5.76. There are a wide range of claimant types and assumptions that could reasonably be adopted. However, given the evidence available our view is that a range 0.7% to 1.4% should cover the median net real returns for the majority of claimants.

5.77. One exception to this is in relation to the 60-year claimant type, where a lower tax assumption results in a median net real return above 1.4% p.a. This lower assumption would be justifiable where the use of more sophisticated tax efficient investments could reduce the tax impact, even after allowing for the costs of specialist tax advice. The GAD Analytical Report includes sensitivity analysis which highlights the impact of utilising different assumptions such as for tax.

5.78. Another exception is the 10-year claimant, where the shorter term and higher cash reserve results in a median net real return around 0.3% p.a. This is dealt with in Sections 6 and 7, as well as the GAD Analytical Report.

5.79. If the PIDR were set to equal the median net real return, then there is a 50% chance that claimants will receive less than sufficient compensation (subject to all other assumptions being borne out in practice) and a 50% chance that compensation would be above that. The returns in the table above, within the range 0.7% to 1.4%, are therefore an important starting point for the Lord Chancellor's consideration.

5.80. For example, if the PIDR were set at +1.4%, and all other assumptions borne out in practice, the 40-year claimant would have a 50% chance of receiving at least sufficient compensation. However, at this level, the 20- and 60-year claimants would have less than a 50% chance of sufficient compensation.

5.81. Conversely, if the rate were set at +0.7%, the 20-year claimant would have a 50% chance of at least sufficient compensation and the 40- and 60-year claimants would have more than a 50% chance of at least sufficient compensation.

5.82. When considering the individual components of the median net real return in this section, we have rounded to the nearest 0.1%. In the rest of this report, for simplicity and to avoid spurious precision, we present PIDRs rounded to the nearest 0.25%.

5.83. As the results for the three core claimant types suggest a median net real return range of 0.7% to 1.4% p.a., we examine outcomes for PIDRs between +0.5% and +1.5% (as well as for the existing PIDR rate of -0.25%). Results for a broader range of PIDRs are shown in the GAD Analytical Report.

6. Allowing for uncertainty in setting the PIDR

6.1. We are seeking to advise the Lord Chancellor on a range for the PIDR that provides an appropriate likelihood that claimants receive sufficient compensation to meet their needs. In doing so, we have considered the balance between:

- the ***likelihood*** that certain groups of claimants are under-compensated, whilst others are over-compensated; and
- the ***extent*** to which certain groups of claimants are potentially under-compensated, whilst others are over-compensated.

6.2. We have considered three types of factors which create uncertainty in the outcomes claimants might achieve.

6.3. First, there is a wide range of possible economic conditions and investment scenarios that might emerge in practice, impacting the investment returns claimants receive over the period that they invest their lump sum. To understand this variability further, we have commissioned analysis from GAD to provide an assessment of the probability of different claimant outcomes. We have used this in our judgement of what over- and under-compensation means in practice, to inform the Lord Chancellor's decision.

6.4. Secondly, there are a wider plausible range of claimants than just the three core claimant types chosen to reflect the factors outlined in Section 5. We have focused on the core claimants to establish a range for the PIDR and then tested the impact of this through sensitivity analysis covering the broader claimant universe.

6.5. Finally, there is a feasible alternative range around our assumptions for investment returns, damage inflation, expenses and tax. These differences emerge due to plausible different judgements about the available evidence, or reasonable alternative approaches to the underlying analysis. We have tested the impact of varying key assumptions and approaches on claimant outcomes and reflected this in our advice on an appropriate range for the PIDR.

6.6. The nature of economic uncertainty means that no PIDR will deliver a specific level of compensation with certainty. In addition, differences in claimant circumstances and choices mean that not all claimants will achieve the same compensation level for a given PIDR. Our understanding of the CLA is that claimants should be more likely to be over-compensated than under-compensated. We have therefore established a set of principles against which to assess options for the PIDR, as follows:

- The majority of claimants should be more likely to be over-compensated than under-compensated.
- High risk of significant under-compensation should be avoided.
- Significant levels of over-compensation should be limited to the extent possible.
- Subject to the above, limiting the likelihood and extent of under-compensation should be given greater weight than limiting over-compensation. Thus, the likelihood of significant under-compensation should ideally be less than the likelihood of significant over-compensation.

At least 100% and 90% sufficiency

6.7. The principle that claimants are more likely to be over-compensated than under-compensated means that across the claimant universe as a whole, there should be a 50% likelihood or more of achieving at least sufficient compensation.

6.8. We have paid particular attention to those scenarios in which compensation levels are not sufficient to meet a claimant's needs. We have sought to limit the risk of significant under-compensation, which we define as less than 90% of a claimant's future needs being met (90% sufficient).

6.9. The Lord Chancellor will ultimately need to make a judgement on the appropriate levels of compensation and likelihoods to be applied. Table 6.1 below sets out the likelihood of achieving at least 100% sufficient and at least 90% sufficient compensation for the three core claimant types. Those scenarios with a 50% likelihood or more of at least sufficient compensation are highlighted in bold and grey.

Table 6.1 Likelihood of achieving at least 90% and at least 100% compensation across core claimant types for different PIDRs

		Core claimant type					
		20-year		40-year		60-year	
		Likelihood of achieving compensation level of at least…					
		90%	100%	90%	100%	90%	100%
PIDR	-0.25%	93%	**76%**	95%	**89%**	88%	**81%**
	...						
	0.50%	83%	**55%**	87%	**76%**	75%	**64%**
	0.75%	78%	47%	83%	**69%**	70%	**58%**
	1.00%	73%	40%	78%	**63%**	64%	**50%**
	1.25%	67%	32%	72%	**55%**	57%	43%
	1.50%	60%	25%	66%	48%	50%	36%

6.10. At a PIDR of +1.5%, none of the core claimant types have a 50% or more likelihood of achieving at least sufficient compensation. Thus, a PIDR at this level does not appear to provide for the majority of claimants to be more likely to be over-compensated than under-compensated.

6.11. As such, we consider that a PIDR of +1.25% would be the maximum PIDR to deliver a 50% or more likelihood of receiving at least sufficient compensation for any of the core claimant types (delivering a 55% likelihood for the 40-year claimant), albeit it does not do so across all the core claimant types. It does provide around a two-thirds likelihood and almost a 60% likelihood of the 20- and 60-year claimants being at least 90% compensated respectively.

6.12. A PIDR of +1% would deliver a 50% or more likelihood of receiving at least sufficient compensation for the 40-year and 60-year claimants. The 20-year claimant would have around a 40% likelihood of receiving at least sufficient compensation and an almost 75% likelihood of being at least 90% compensated.

6.13. A PIDR of +0.75% would deliver a 50% or more likelihood of receiving at least sufficient compensation for the 40-year and 60-year claimants. The 20-year claimant would have very close to a 50% likelihood of receiving at least sufficient compensation and an almost 80% likelihood of being at least 90% compensated.

6.14. A PIDR of +0.5% would be required to ensure at least a 50% likelihood of all core claimant types receiving at least sufficient compensation.

6.15. Although the 20-year claimant has lower likelihoods of achieving at least sufficient compensation compared to the 40- and 60-year claimants, they have similar likelihoods of achieving at least 90% compensation. This is because a more cautious investment strategy is judged suitable for these claimants and also because of their higher levels of cash reserves, which together reduce the variability of outcomes.

Significant under- versus over-compensation

6.16. It is not possible to set the PIDR at a level that limits the likelihood of significant under-compensation without there also being a chance of significant over-compensation. We have therefore sought to limit this to the extent possible. We define significant over-compensation as more than 120% of a claimant's future needs being met (120% sufficient, or 20% over-compensated).

6.17. The risk of under-compensation is of a greater concern than the risk of over-compensation. We therefore compare the likelihood of achieving less than 90% sufficient compensation with the likelihood of being more than 20% over-compensated.

6.18. We have used our judgement to define 90% and 120% sufficient compensation in seeking to balance levels of significant under- and over-compensation respectively. The range also reflects the fact that outcomes are not symmetric around the median investment return.

6.19. These are necessarily subjective judgements, and we have also considered analysis of additional compensation levels (for example 10% or 30% over-compensation). Full analysis is included in the GAD Analytical Report.

6.20. The results are summarised in Table 6.2 below:

Table 6.2 Likelihood of significant under- and over-compensation across core claimant types for different levels of PIDR

		Core claimant type								
		20-year			40-year			60-year		
		Likelihood of achieving compensation level of…								
		less than 90%	90-120%	more than 120%	less than 90%	90-120%	more than 120%	less than 90%	90-120%	more than 120%
PIDR	-0.25%	7%	73%	20%	5%	26%	69%	12%	25%	64%
	…									
	0.50%	17%	76%	7%	13%	42%	45%	25%	34%	41%
	0.75%	22%	74%	5%	17%	45%	37%	30%	37%	33%
	1.00%	27%	70%	3%	22%	48%	30%	36%	38%	26%
	1.25%	33%	65%	2%	28%	50%	22%	43%	38%	19%
	1.50%	40%	58%	1%	34%	51%	16%	50%	36%	14%

6.21. Key observations from this analysis are:

- Under the current rate of -0.25%, there is a more than 50% likelihood of significant over-compensation for the 40- and 60-year claimants, supporting a change to the rate.
- A PIDR in the range +0.5% to +1.25% limits the likelihood of significant over-compensation to less than 50%, for all the core claimant types. For a PIDR of +0.5% there is a higher likelihood of significant over-compensation (over 40% for two of the three core claimant types) when compared to a PIDR of +0.75% or above.
- There is much less likelihood of the 20-year claimant being significantly over-compensated than for the 40- or 60-year claimants.
- When considering thresholds for achieving a lower likelihood of significant under-compensation compared to significant over-compensation, the 40- and 60-year claimants, would require a PIDR around +1% and around +0.75% respectively. For the 20-year and shorter-term claimants this is not possible without materially reducing the PIDR to an extent that is likely to significantly over-compensate the majority of claimants.

6.22. We recognise that there are limitations in this analysis, some of which we test further in the sensitivity analysis discussed below. For example, for the 60-year claimants, the probabilities of achieving the stated levels of sufficient compensation are potentially understated in at least some cases, where lower tax costs could be experienced.

6.23. Potentially offsetting this, the analysis does not model claimants' (and their advisers') reactions to materially stronger or weaker investment performance than expected and also assumes a fixed tax assumption across modelled simulations, regardless of investment returns.

6.24. All of these factors have more impact on longer-term claimants and reinforce that this analysis should not be used to calibrate to a precise level or risk of claimant compensation. Nonetheless, in our view, the analysis is suitable to support the Lord Chancellor's decision on the PIDR.

Other sensitivities

6.25. The economic uncertainty highlighted above is just one reason why claimant outcomes might differ from expected. We have also considered the impact of a claimant having different features to those considered in the core claimant range and the impact of assumptions being different from our core estimates. Details are set out in the GAD Analytical Report.

Median net real return for additional claimant types

6.26. The additional claimant types reflect variations in the factors impacting claimant outcomes described in Section 5. Key factors that have been considered are: the size of the lump sum and term of investment period, particularly the impact of lower lump sum sizes for 40 and 60 year terms, compared to those assumed for the core claimant types; and preferences for a higher- or lower-risk investment strategy than assumed for the core claimant types. Together, these factors influence levels of expenses and tax, and this has been reflected in the analysis.

6.27. We conclude that variations by lump sum size, term and risk preference do not result in a median net real return below the range of +0.5% to +1.25% considered above for the core claimant types, with one notable exception for a claimant with a significantly shorter investment term of 10 years. The median net real return in this scenario is around +0.3% p.a.

6.28. In forming our advice, we recognise that the PIDR has the least material impact on shorter-term claimants and adjusting the PIDR for this group would potentially lead to over-compensation for a majority of claimants.

6.29. In addition, the likelihood of achieving at least 90% sufficient compensation for a 10-year claimant is actually higher than for longer-term claimants, due to the shorter term and lower risk investment approach adopted (they would have over 75% likelihood of at least 90% compensation, even if the PIDR was set as high as 1.25%). This is discussed further in Section 7 on dual rate considerations.

6.30. The scenarios which are above the range of +0.5% to +1.25% are where either more investment risk is assumed (moving from the central portfolio to a less cautious portfolio for a 40-year claimant) or less tax is assumed (reducing the lump sum size from £5m to £1m for a 60-year claimant, which predominately impacts the tax assumption).

Sensitivity around core assumptions

6.31. We have also considered a range around each of the other core assumptions impacting claimant outcomes, namely other income, expenses, tax and damage inflation. The most material factors are the assumptions for expenses and tax. Given that there are choices available to claimants to manage these factors, we do not believe that this would produce a median net real return that is lower than the +0.5% to +1.25% range.

6.32. We recognise that some claimants may be able to reduce expenses or tax costs, and thus achieve a real rate of return that is higher than this range. However, we believe the assumptions should be considered as a whole and we do not have sufficient evidence to support reducing these assumptions for expenses and tax across the claimant universe as a whole.

Summary

6.33. A PIDR of +1.25% does not sufficiently meet the principles across the claimant universe. In particular, it does not deliver at least 50% likelihood of achieving at least sufficient compensation for the majority of claimant types modelled.

6.34. A PIDR of +0.5% satisfies the majority of the principles. In particular, it achieves at least sufficient compensation for the majority of claimant types modelled. However, it has somewhat higher likelihoods of significant over-compensation compared to higher PIDRs.

6.35. A PIDR of +0.75% satisfies the majority of principles across the core claimant types considered.

6.36. A PIDR of +1% satisfies the majority of the principles across the core claimant types considered. However, it has somewhat higher likelihoods of significant under-compensation, and lower likelihoods of at least sufficient compensation compared lower PIDRs.

6.37. In considering the sensitivity analysis, our view is that it is reasonable for the Lord Chancellor to base her assessment on the outcomes for the core claimant types, without a further adjustment to the range +0.5 to +1.25% to allow for outcomes for additional claimants or assumptions deviating from our core assumptions.

7. Analysis of dual or multiple rates

7.1. The 2019 Government Actuary's report outlined the technical arguments for moving to a dual rate by term of award, given the difference in expected investment returns for shorter- and longer-term claim periods observed at that time. It also effectively set out the key policy options for the Government, including around the switching point and determination of the long-term rate against a short-term rate. HM Treasury's consultation response also suggested that the Lord Chancellor commit to testing the viability of a dual rate with stakeholders in advance of the next rate review.

7.2. In his statement of reasons to support the 2019 PIDR review, the then-Lord Chancellor said that, whilst the case for dual rates by term was worth consideration, he did not see that there was sufficient evidence in favour of implementing more than one rate at that time. However, in accordance with HM Treasury's recommendation, he committed to consulting further on the matter.

7.3. In forming our advice, we have considered the outputs of that evidence gathering process, primarily the responses to the 2023 Call for Evidence on Dual and Multiple rates and sought further information in the 2024 Call for Evidence. We have also drawn on the experiences of other jurisdictions with dual or multiple rates in effect. In addition, a wider range of options has been considered than that by the Government Actuary at the 2019 review, including consideration of multiple rates by heads of loss.

7.4. In considering the issue of the desirability of dual or multiple rates, we have taken into account:

- their potential to result in a more accurate reflection of claimants' needs, by allowing for differences in expected investment returns or damage inflation;
- their potential to result in closer to 100% sufficient compensation for a greater proportion of claimants; and
- the practical implementation implications.

7.5. A significant majority of respondents to the Calls for Evidence, both on the claimant and defendant side, were not in favour of implementing dual or multiple rates either by term of award or heads of loss.

7.6. They recognised the theoretical benefits in better tailoring the PIDR to a claimant's likely investment return and that analytically this would be straightforward to do. However, they felt that in reality, these benefits were likely to be outweighed by the adverse impact on the claims process and by the practical implementation challenges.

7.7. There was a clear view that additional complexity would lead to delays in settling claims, as well as an increased likelihood of satellite litigation. There were also concerns that this complexity would reduce the transparency and clarity of the claims process for all parties.

7.8. Respondents also stressed that dual or multiple rates would require a lead-in time, allowing for appropriate training to take place, as well as the updating of any relevant calculators, publications, and IT systems, which could cause delays during the transition period. More details on stakeholders concerns on the additional costs and complexity introduced by dual or multiple rates are provided in the responses to the Calls for Evidence.

7.9. Given the views of key stakeholders against a shift away from a single PIDR rate, there would need to be substantial benefits for claimants for the Lord Chancellor to consider introducing dual or multiple rates. Therefore, we commissioned GAD to undertake analysis to explore these potential benefits.

7.10. Our conclusion is that, overall, while a shift away from a single rate approach could help improve the likelihood of claimants receiving sufficient compensation, under current market conditions it is not clear that the benefits of multiple rates (either by term of award or heads of loss) would be sufficient to offset the likely disadvantages.

Dual rates by term

7.11. The option of dual or multiple rates by term is something that has been used in other jurisdictions, and there are different potential options for dealing with the transition between rates when setting compensation.

7.12. If multiple rates were to be implemented, most respondents to the Calls for Evidence suggested that two rates (one short- and one long-term) would be sufficient, with further rates only adding further complexity.

7.13. It was also commonly commented that a methodology similar to that adopted in Ontario, Canada[5] when switching between the rates, would provide a reasonable balance between complexity and avoiding so-called 'cliff edges' in settlement amounts.

[5] https://www.ontario.ca/page/future-pecuniary-damage-awards

7.14. Responders also broadly coalesced around suggesting a 10 to 15-year period, as being suitable for the switch point, with a majority favouring the lower end of that range, which we considered reasonable.

7.15. If dual rates by term were adopted, then to be effective, the short-term rate needs to be reviewed and potentially changed regularly to reflect the investment environment. This has the potential to create uncertainty and have an adverse impact on the claims process.

7.16. Considering the evidence set out above, the Panel commissioned GAD to produce a dual rate model, based on a short-term PIDR and a long-term PIDR with a ‘switching point’ of 10 years. The short-term PIDR is applied to all damage payments before the switching point and those payments beyond this point are subject to the short-term PIDR for the first 10 years and the long-term PIDR thereafter.

Benefits of a dual rate by term

7.17. The primary benefit of a dual rate by term, is that it can help reduce the disparities in expected outcomes (i.e. compensation levels), between claimants with differing damage terms.

7.18. This can be illustrated by comparing the likelihoods under a single and dual rate approach of 100% and 90% compensation for each of the three claimant types, plus a 10-year claimant.

7.19. A dual rate of +0.25% in the short term and +1.5% in the long term, and a single rate of +1% was used for illustrative purposes. These do not represent the Panel’s advice on particular rates. However, they are sufficient to quantify the impact of dual rates compared to a single rate and to draw relevant conclusions.

7.20. This analysis is summarised in Table 7.1 below. It shows that a dual rate mechanism can increase the likelihoods of sufficient compensation for shorter-term claimants, without significantly changing the likelihood of over-compensation for longer-term claimants. However, these benefits are more limited when considering the likelihoods of achieving at least 90% compensation, which are already relatively high for shorter-term claimants under a single rate.

Table 7.1 Likelihood of at least 100% and 90% sufficient compensation comparison of dual rate by term versus single rate approach

		Single rate: 1.00%		Dual rate: Short: 0.25% Long: 1.50%	
	Likelihood of compensation of at least …	100%	90%	100%	90%
Claimant type	10-year	28%	82%	50%	91%
	20-year	40%	73%	54%	83%
	40-year	63%	78%	66%	80%
	60-year	50%	64%	51%	64%

7.21. For example, under a single rate of +1%, a 10-year claimant has around a 30% likelihood of achieving at least sufficient (100%) compensation, but around an 80% likelihood of achieving at least 90% sufficient compensation. A dual rate significantly increases the likelihood of being 100% compensated to around 50% but only increases the likelihood of being 90% compensated to around 90%.

Rates by heads of loss

7.22. An alternative to multiple rates by term of award would be to consider multiple rates by heads of loss, to reflect different rates of damage inflation for different types of loss.

7.23. A significant majority of respondents to the Calls for Evidence, both on the claimant and defendant side, were not in favour of implementing rates by heads of loss.

7.24. Additionally, whilst respondents could see the benefits to shorter-term claimants of having rates by term of award, no particular groups were identified that would benefit from rates split by heads of loss. This is discussed in more detail below but is primarily driven by the current claims process leading to lump sums being agreed in the round, rather than by individual heads of loss. As such, we recommend that multiple rates by heads of loss are not implemented, unless there is a significant change in the views of key stakeholders or the settlement process.

7.25. If multiple rates by heads of loss were implemented, most respondents to the CfE suggested that two rates, grouped by earnings inflation types and price inflation types, would be sufficient, with further rates only adding further complexity. A two-rate system is used in the Republic of Ireland[6].

Benefits of a dual rate by heads of loss

7.26. In the single rate analysis, we have assumed that claimants have a mix of damages that are primarily earnings related (65%-85%), with the balance related to inflation as measured by CPI. Taken together we have assumed that all claimants experience damage inflation of CPI+1% p.a.

7.27. In practice, some claimants will be over-compensated if they have a lower proportion of damages related to earnings, whilst others will be under-compensated should they have a higher proportion related to earnings.

7.28. The GAD analysis illustrates the impact of a dual rate by heads of loss as follows:

- For the 40-year core claimant type with 100% earnings-related damages, achieving at least a 50% likelihood of being at least sufficiently compensated would require a single-rate PIDR which is 0.25% lower.

- For the 40-year core claimant type with 50% earnings-related damages, achieving at least a 50% likelihood of being at least sufficiently compensated would require a single-rate PIDR which is 0.4% higher.

7.29. Therefore, having separate PIDRs for different heads of loss could financially benefit some claimants, while limiting over-compensation. A dual-rate approach by heads of loss is also relatively straightforward to implement from an ongoing calculation perspective, as there would effectively just be two different discount rates that could be applied to different proportions of the claim, using existing Ogden Tables. Agreeing what those proportions are is where the significant limitations of this approach manifest, as it would make agreeing settlements between parties harder.

[6] https://www.gov.ie/en/press-release/181e7-minister-mcentee-publishes-reports-on-index-and-discount-rates-for-payments-to-catastrophically-injured-people/

Summary of advice on dual rates

7.30. While a shift away from a single rate approach could help improve the likelihood of claimants receiving full compensation, we do not consider that the benefits of dual rates (either by term or heads of loss) would currently be sufficient to offset the likely disadvantages.

7.31. Unless there were a significant change to either stakeholder views or underlying claim features and expected market outcomes, the conclusion of this analysis on dual rates is likely to persist in future reviews of the PIDR.

7.32. However, given the wide range of possible ways in which a dual rate could be set, if the Lord Chancellor would like to consider this going forward, then we recommend that a more defined dual rate methodology is explored in more detail in advance of the next review. This would have the benefit of presenting a Lord Chancellor with clearer choice between a single and a dual rate at that review, and also give stakeholders time to plan how a dual rate might be implemented.

8. Summary of advice

8.1. We are seeking to advise the Lord Chancellor on a range for the PIDR that provides an appropriate likelihood that claimants receive sufficient compensation to meet their needs.

8.2. In our experience, and supported by the evidence gathered for this review, claimants have a wide range of different characteristics. Attempting to model the whole claimant universe would not be feasible. Rather, we have considered the analysis of outcomes for three core claimant types: '20-, 40- and 60-year', designed to cover key claimant characteristics.

8.3. We have also tested the sensitivity of our conclusions across a wider range of additional claimants, and alternative assumptions, to ensure our advice on the PIDR is broadly appropriate across the wider universe. Based on this analysis, we do not consider it necessary to make a further adjustment to our advice in addition to considering the three core claimant types.

8.4. In judging an appropriate rate for the PIDR based on this analysis, the Lord Chancellor will need to consider:

- the appropriate likelihoods and target levels of compensation to apply in this review;
- the outcomes for different claimant groups, and balancing the likelihoods of over- and under-compensation; and
- the limitations in both the analysis and the evidence for this review.

8.5. There are other uncertainties and factors that a claimant may face that are not included in our analysis, for example the risk that the claimant lives longer than expected.

8.6. The outcomes for claimants against the principles which we have established to assess options for the PIDR are summarised in Table 8.1 below:

Table 8.1 Compensation levels across core claimant types for different PIDRs

	Core claimant type											
	20-year				40-year				60-year			
PIDR	Likelihood of achieving compensation level of…											
	at least 100%	less than 90%	90-120%	more than 120%	at least 100%	less than 90%	90-120%	more than 120%	at least 100%	less than 90%	90-120%	more than 120%
0.50%	**55%**	17%	76%	7%	**76%**	13%	42%	45%	**64%**	25%	34%	41%
0.75%	**47%**	22%	74%	5%	**69%**	17%	45%	37%	**58%**	30%	37%	33%
1.00%	**40%**	27%	70%	3%	**63%**	22%	48%	30%	**50%**	36%	38%	26%
1.25%	**32%**	33%	65%	2%	**55%**	28%	50%	22%	**43%**	43%	38%	19%

8.7. Based on the analysis in this and the GAD Analytical Report, we conclude:

- A PIDR of +1.25% does not sufficiently meet the principle of achieving at least sufficient compensation for the majority of claimant types modelled.
- A PIDR of +0.5% satisfies the majority of the principles, achieving at least sufficient compensation for the majority of claimant types modelled. However, it has somewhat higher likelihoods of significant over-compensation compared to higher PIDRs.
- A PIDR of +0.75% satisfies the majority of the principles across the core claimant types considered.
- A PIDR of +1% satisfies the majority of the principles across the core claimant types considered. However, it has somewhat higher likelihoods of significant under-compensation, and lower likelihoods of at least sufficient compensation compared to lower PIDRs.

8.8. One way to achieve a higher likelihood of at least sufficient compensation across all claimants would be to consider introducing multiple rates, defined either by term or by heads of loss. However, we do not recommend this because the potential benefits to claimants do not currently appear to justify the additional complexity, delay, and expense it would introduce to the claim process.

8.9. Unless there were a significant change to either stakeholder views or underlying claim features and expected market outcomes, the conclusion reached in this review on multiple rates is likely to persist in future reviews of the PIDR. However, given the wide range of possible ways in which a multiple rate could be set, if the Lord Chancellor would like to consider this going forward, we recommend that a more defined multiple rate methodology is examined in depth in advance of the next review.

8.10. Finally, we emphasise that the analysis carried out should not be relied on as a precise means of calibrating to a particular level or risk of claimant compensation but should be used as an overall indication of the potential risks that claimants might face.

Appendix A: Scope of the Panel's work

A.1 This report sets out the Panel's advice to inform the Lord Chancellor's review of the PIDR. It provides advice in relation to the investment returns (or range of returns) that it is reasonable to expect the recipient of relevant damages to achieve, the risk associated with these, and the costs and expenses claimants are likely to face.

A.2 Our report does not set the PIDR rate, but provides advice to inform the Lord Chancellor's decision.

A.3 The Panel was formed in July 2023 to prepare for this review. We have engaged with stakeholders to gather background evidence and commissioned analysis from GAD. Through these activities we have had the opportunity to challenge the information we have received, deliberate on the relevant issues, and seek additional information and analysis where required.

A.4 This report is not an exhaustive account of the information that we have considered, but the key factors which have informed our judgements are summarised in the relevant sections of this report. The analysis which we have commissioned from GAD will be made public alongside this report as the GAD Analytical Report.

A.5 This report is also based on information available at the time of submitting this report to the Lord Chancellor. The Panel will remain available to the Lord Chancellor should new information materially change our advice before her review is completed. Once the review is complete the Panel will be disbanded and therefore separate advice would be required on whether an out-of-cycle review should be considered if a material change occurs (for example, significant changes in economic conditions or the tax regime).

A.6 The role and responsibilities of the Panel are set out in our Terms of Reference in Appendix B. We recognise that it is not possible to achieve exactly sufficient (100%) compensation for all claimants. As such, we provide the Lord Chancellor with options for setting the PIDR, with varying degrees of confidence. To develop our advice we have established some guiding principles as set out in Section 6, albeit we recognise that there is no single PIDR which meets these completely across the claimant universe.

A.7 The CLA provides the flexibility for the Lord Chancellor to set multiple discount rates to apply to different parts of a claimant's settlement. We have included analysis and considered stakeholders' views on the merits of a dual rate by term of award and a dual rate by heads of loss, to advise the Lord Chancellor in this respect. Given our conclusions that any merits of such approaches would be outweighed by costs and complexity, we have not undertaken detailed analysis to set out a range of dual PIDRs.

A.8 The review and setting of the PIDR has inherent limitations. In particular, there are evidence gaps as a result of data not being publicly available or not being retained by parties to the claims process. In forming appropriate assumptions, we have used the range of experience within the Panel to interpret the data that are available and make judgements on the weight and quality of information from multiple sources. Recognising the variety of claimant circumstances and data limitations, our approach has been to seek to capture the characteristics of a broad range of claimants, rather than defining a single 'representative' claimant.

A.9 Although the PIDR is an essential part of calculating compensation for serious personal injury, it is only one part of a process which includes numerous estimates, assumptions and uncertainties which impact claimant outcomes in practice, and which are outside the scope of the PIDR review. These include:

- Longevity risk – Claimants with a lump sum are exposed to longevity risks, in that they could live longer than is assumed in the settlement. We recognise that longevity risk is a key concern for claimants, but we do not consider that an allowance for it should be made through an adjustment to the PIDR, given the requirement in the CLA to assume the lump sum is exhausted at the end of the assumed period.

- Availability of PPOs – PPOs can provide greater certainty to a claimant, by removing investment and longevity risk, because payments are made over the entire course of a claimant's life. Our analysis demonstrates that longevity risk is more material for shorter-term claimants, and thus, where they are available, PPOs could provide a more secure outcome for these claimants. For the purpose of our advice, we are required to focus on lump sum settlements.

- Changing needs – Claimants' needs may change over time, impacting the amount they need to withdraw from their asset portfolio and creating the potential for them to exhaust their lump sum before the end of the assumed investment period. The risk of changing needs is implicitly accepted by the claimant as part of the settlement and thus we have made no allowance for this in formulating our advice.

- Ogden Tables – Once the PIDR is determined, claims are valued using the multipliers and adjustment factors in the Ogden Tables. These reflect assumptions about future life expectancy and other relevant factors, such as the how much time the claimant would have spent in work had they not been injured. These are prepared by an inter-disciplinary working party. We note that there will potentially be a need to update these tables to reflect the decision on the PIDR and to ensure the underlying assumptions are up-to-date.

A.10 Other than the Lord Chancellor, the Ministry of Justice and HM Treasury, no person or third party is entitled to place any reliance on the contents of this report, except to any extent explicitly stated herein. The Expert Panel has no liability to any person or third party for any action taken or for any failure to act, either in whole or in part, on the basis of this report.

A.11 We understand that this report will be made public alongside other documents relevant to the determination of the Personal Injury Discount Rate.

A.12 This report has been produced in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.

Appendix B: Expert Panel Terms of Reference

Background

1. The Personal Injury Discount Rate (PIDR) is a statutory method for the way lump sum compensation for future financial loss is calculated in serious personal injury cases (i.e. those whose impacts are expected to last for a period of years).

2. In such cases, some or all of the compensation is received in the form of a lump sum payment which claimants often invest. The purpose of the PIDR is to reflect the return that a claimant could reasonably be expected to receive from investing the lump sum element of damages which, along with the nature of the injury and its expected term, will determine the size of the lump sum.

3. The PIDR is therefore an essential part of calculating appropriate levels of compensation in cases of serious injury and it is the duty of the Lord Chancellor under the Damages Act 1996 to set the PIDR.

4. Part 2 of the Civil Liability Act 2018 (CLA) specifies a new methodology for the setting of the Personal Injury Discount Rate. The Act stipulates that the Lord Chancellor must establish an Expert Panel, chaired by the Government Actuary, who the Lord Chancellor will consult on the setting of the rate.

5. It was the intention behind the new provisions that the Panel will bring additional expertise into the review process, leading to a better system for the setting of the rate.

Expert Panel responsibilities and scope

6. The PIDR Expert Panel must be established and maintained by the Ministry of Justice.

7. The Panel has to be appointed by, and provide independent advice to, the Lord Chancellor.

8. The Lord Chancellor must begin conducting a review of the rate no later than five years after the previous review was completed. Upon announcing the start of the review, the Lord Chancellor must make a determination within **180 days**. In doing so, as per the CLA, the Lord Chancellor must consult HM Treasury and the Expert Panel.

9. The Expert Panel must respond to the Lord Chancellor's consultation within **90 days**, beginning with the day on which its response is requested.

10. As an advisory body, the Panel's role is not to set the rate, but to provide advice with respect to the Lord Chancellor's consideration of the PIDR and it must take into account the duties of the Lord Chancellor under paragraph 4 of Schedule A1 to the CLA in its response.

11. The Lord Chancellor is free to depart from the advice of the Expert Panel, if he or she believes that the fulfilment of his or her statutory duties in relation to the setting of the rate requires it.

12. To help the Lord Chancellor determine the rate, and with due regard to the various methodological approaches available, amongst any other matters the Panel considers appropriate, the Panel should provide advice in relation to the returns (or range of returns) that it is reasonable to expect the recipients of relevant damages to achieve, and the risk associated with this. In doing so the Panel should take into account:

a. how claimants invest over differing periods and the investments that are available;

b. the extent to which claimants can be considered to be similar to ordinary investors;

c. what assets might exist within a low-risk diversified portfolio suitable for properly advised claimants;

d. the most appropriate measure of inflation to use when setting the discount rate;

e. allowances to be made for management costs, taxation and inflation in the setting of the rate;

f. the possibility of setting dual or multiple rates and the implications on a. to d. above of such an approach and;

g. wider factors deemed relevant, for example, international comparisons and economic factors.

13. In considering their advice to the Lord Chancellor, the Expert Panel may, amongst any other things it considers appropriate:

a. invite others (outside of the four members and Chair) to attend or speak at meetings;

b. consult externally and;

c. commission information or analysis.

14. Ultimately, the Panel will be required to provide options, with varying degrees of confidence, to the Lord Chancellor. These options will be informed by members' expert knowledge and any additional insight gained from the activities of the Panel. It will be for the Panel to determine, with advice from the Ministry of Justice as appropriate, the format in which options are provided to the Lord Chancellor. The Lord Chancellor may ask questions, or seek clarification or discussion with the Expert Panel following the provision of options.

15. It is the requirement of the Expert Panel to set out a clear rationale for its advice, positions and any assumptions made.

16. It is expected that some of the Expert Panel's advice to the Lord Chancellor will be made public.

Membership

17. The Expert Panel will be chaired by the Government Actuary, with four other Panel members appointed by the Lord Chancellor, as set out in the CLA:

a. one member with experience as an actuary;

b. one member with experience of managing investments;

c. one member with experience as an economist; and

d. one member with experience in consumer matters as relating to investments.

18. Acting as a statutory consultee will not restrict or inhibit the ability of the Government Actuary to provide advice independently of the Panel to the Lord Chancellor, HM Treasury and the Ministry of Justice outside the scope of the consultation at any time, including during the review period.

19. During any period when the office of Government Actuary is vacant, the Deputy Government Actuary is to be a member of the Panel and is to chair it (Schedule A1, paragraph 6(8), Part 2, CLA).

20. Expert Panel members will be appointed for each review only. The Panel will cease to exist once the Lord Chancellor has made a decision and the review has ended. It is expected that the Expert Panel will be convened for approximately 1.5 years in total (July 2023 – November 2024).

21. Some or all of the members of the Expert Panel are likely to be members of representative organisations. Whilst their experience and expertise may be informed by their membership of such an organisation, once appointed, they will be acting in their individual expert capacities and will not be representing any other body.

22. Expert Panel members are required to disclose potential conflicts of interest on an ongoing basis.

23. Panel members have a duty to maintain confidentiality at all times and must not discuss the details of any work or deliberations of the Expert Panel outside of meetings. Panel members must be mindful that, whilst the Lord Chancellor may depart from the advice of the Expert Panel, details of discussions and deliberations are commercially sensitive and could still have an undue impact upon industry and markets. Further, as the Ministry of Justice is providing the secretariat functions for the Expert Panel, materials produced will be subject to the Freedom of Information Act.

24. The Government Actuary's Department retains the copyright, and rights in the nature of copyright, in works shared with or carried out for the Expert Panel. The disclosure of any such information is strictly prohibited and constitutes a breach of these terms, and may result in termination of Panel membership.

25. Panel members have been appointed through an open and competitive process which aligned with the Governance Code on Public Appointments, and are required to adhere to the seven principles of public life:

a. **Selflessness:** holders of public office should act solely in terms of the public interest.

b. **Integrity:** appointees must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family or their friends. They must declare and resolve any interests and relationships.

c. **Accountability:** holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.

d. **Objectivity**: appointees must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.

e. **Openness**: appointees should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.

f. **Honesty:** holders of public office should be truthful.

g. **Leadership:** holders of public office should exhibit these principles in their own behaviour and treat others with respect. They should actively promote and robustly support the principles and challenge poor behaviour wherever it occurs.

26. As set out in the CLA, the Lord Chancellor may end an appointed member's membership of the Panel if the Lord Chancellor is satisfied that:

a. the person is unable or unwilling to take part in the Panel's activities;

b. it is no longer appropriate for the person to be a member of the Panel because of gross misconduct or impropriety; or

c. the person has become bankrupt, a debt relief order (under Part 7A of the Insolvency Act 1986) has been made in respect of the person, the person's estate has been sequestrated or the person has made an arrangement with or has been granted a trust deed for creditors.

27. Panel members are expected to uphold and operate in accordance with the stated principles at all times. The Lord Chancellor may terminate an appointed member's membership of the Panel if the Lord Chancellor is satisfied that a member is found to be in violation of these principles.

28. As per the CLA, the Lord Chancellor will make arrangements for the appointed members of the Expert Panel to be paid any remuneration and expenses considered appropriate and commensurate with Ministry of Justice policies.

Ways of working

Functioning

29. The quorum of the Expert Panel is four members, one of whom must be the Government Actuary (or the Deputy Government Actuary when the office of Government Actuary is vacant). In the event of a tied vote on any decision, the person acting as chair of the Panel is to have a second, casting vote.

30. The Ministry of Justice will provide the Expert Panel with a dedicated secretariat who will take minutes of the meetings, which will be approved by the Panel.

31. The Expert Panel is required to reach an official view by majority decision on the options to be provided to the Lord Chancellor in a transparent, effective and efficient way and document the process.

32. If a person appointed ceases to be a member (as per paragraph 25 or otherwise) the Expert Panel can continue to meet if quorum is achieved, whilst a replacement will be recruited. If two persons appointed cease to be members, replacements will be recruited, and the Expert Panel will not be able to meet until quorate. In such circumstances, recruitment of the replacement may be made via direct appointment, to ensure the impact upon the Expert Panel's timeline is minimised.

Activities

33. Prior to the formal request from the Lord Chancellor, the Expert Panel may begin gathering intelligence by commissioning, consulting and meeting as they consider appropriate in preparation for their response. Information and evidence commissioned and gathered by the Expert Panel will be shared with HM Treasury who are also consultees under the CLA.

34. Expert Panel members, in their deliberations, should consider responses to the Call for Evidence on a Dual/Multiple Rate approach. In 2019, this consultation was committed to by the then Lord Chancellor "to inform the next discount review and the work of the Expert Panel".

Appendix C: Letter of consultation from the Lord Chancellor

Ministry of Justice

The Right Honourable
Shabana Mahmood MP
Lord Chancellor & Secretary of State for Justice

Fiona Dunsire
Chair of the Personal Injury Discount Rate Expert Panel
Government Actuary's Department
6th Floor, 10 South Colonnade
London
E14 4PU

MoJ ref: SUB115490

15 July 2024

Dear Fiona,

REVIEW OF THE PERSONAL INJURY DISCOUNT RATE 2024

I am writing to formally consult the Expert Panel on conducting the 2024 review of the Personal Injury Discount Rate (PIDR) under paragraph 1 of Schedule A1 to the Damages Act 1996 as inserted by section 10(2) of the Civil Liability Act 2018 (the Act).

As per your terms of reference, the Expert Panel will be providing advice on matters relevant to setting the rate. Taking into account the duties of the Lord Chancellor under paragraph 4 of Schedule A1 to the Damages Act 1996, the panel must be consulted regarding the returns (or range of returns) that it is reasonable to expect the recipients of relevant damages to achieve, and the risk associated with this. In doing so the panel should take into account:

a. how claimants invest over differing periods and the investments that are available;
b. the extent to which claimants can be considered to be similar to ordinary investors;
c. what assets might exist within a low-risk diversified portfolio suitable for properly advised claimants;
d. the most appropriate measure of inflation to use when setting the discount rate;
e. allowances to be made for management costs, taxation and inflation in the setting of the rate;
f. the possibility of setting dual or multiple rates and the implications on a. to d. above of such an approach and;
g. any wider factors deemed relevant.

This consultation formally commences the statutory review, which is within the 5-year period following the last review (which was published on 15 July 2019). According to the Act, the review must be completed within 180 days. In accordance with this statutory timeline, the Expert Panel must respond to this request within 90 days beginning with the day on which its response to the consultation is requested, so your response is required no later than **13 October 2024**.

T 020 3334 3555
F 0870 761 7753

E https://contact-moj.service.justice.gov.uk/
www.gov.uk/moj

102 Petty France
London
SW1H 9AJ

As per the Damages Act, as amended by the Act, I have also written to the Chancellor of the Exchequer today to formally consult HM Treasury on the review of the rate.

Yours sincerely,

RT HON SHABANA MAHMOOD MP

LORD CHANCELLOR AND SECRETARY OF STATE FOR JUSTICE

T 020 3334 3555
F 0870 761 7753

E https://contact-moj.service.justice.gov.uk/

www.gov.uk/moj

102 Petty France
London
SW1H 9AJ

Appendix D: Expert Panel Members

	**Fiona Dunsire:** Fiona took up the role as Government Actuary on 1 November 2023. She joined the Government Actuary's Department following 35 years of experience in the private sector with Mercer where she held a variety of roles across pensions and investments, including as UK CEO of Mercer from 2012 to 2019. She has a degree in Mathematics with Economics from Strathclyde University and has been a fellow of the Institute and Faculty of Actuaries since 1993.
	**Charl Cronje:** Charl is an actuary with over 30 years of experience. He is a partner of analytics and consulting firm Lane Clark & Peacock LLP. Charl advises insurers, reinsurers and public sector risk pooling schemes on reserving, capital requirements, pricing, M&A, strategy and risk management. He is an expert in motor insurance and medical malpractice insurance, both of which are affected significantly by the Personal Injury Discount Rate.
	**Dr Rebecca Driver:** Rebecca has over 35 years of experience in economic policy research and a background in financial services regulation. She is director of the research consultancy Analytically Driven Ltd and has been a member of numerous boards and advisory panels serving government, industry and academia, including the Financial Services Consumer Panel, which advises the FCA. She holds a PhD in Economics from the University of Exeter, and Masters degrees from the European University Institute and Birkbeck College London.
	**Donald Taylor:** Donald is an investment consultant with 25 years of experience in the industry. He is head of asset model assumptions at WTW, with responsibility for setting and reviewing the assumptions used across WTW covering assets globally across pension schemes, wealth management and insurer reserving. He also advises a mix of clients on their long-term investment strategy and risk management options. Prior to that he was an actuarial consultant for pension schemes.
	**Ed Tomlinson:** Ed is a Chartered Financial planner and head of the Financial Planning team at IM Asset Management, a wholly owned subsidiary of Irwin Mitchell. Ed has been helping clients who have received a personal injury settlement for over 20 years and advising the Courts on the structure of settlements. He has a Bachelor of Science in Mathematics from the University of Sheffield, and is a Fellow of the Personal Finance Society.

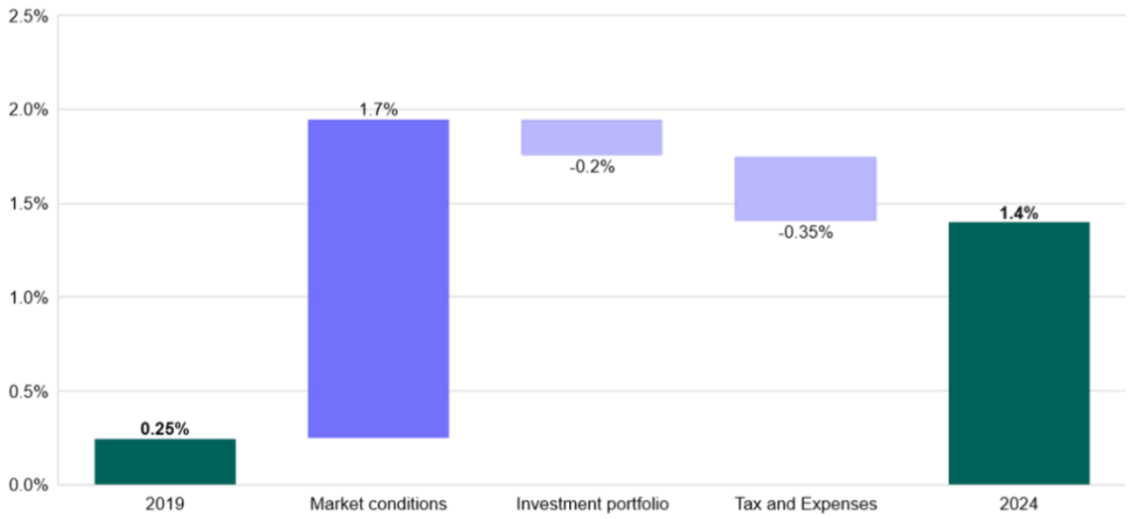
Appendix E: Changes since 2019

The CLA requires that the PIDR is reviewed every 5 years (at the latest) to allow for changes in market conditions that impact investment returns and inflation expectations, and in factors that impact claimant outcomes such as expenses and tax. In addition, the investment environment develops over time so that available asset classes and investment approaches may evolve from one review to the next. Together, these all affect the assumptions for each review.

The median return after damage inflation, expenses and tax for the 'representative claimant' at the 2019 review was 0.25% p.a., whereas the median return for the 40-year claimant after damage inflation, expenses and tax at this review is 1.4% p.a. The chart below shows the approximate impact of assumption changes since the 2019 review:

- There has been a significant change in the economic and investment environment, with higher returns expected from most asset classes. This means the median expected return for the central portfolio has increased significantly compared to 2019.
- The central portfolio has also been updated at this review to reflect the current evidence, in particular that claimants hold a cash reserve alongside their invested portfolio. This reduces the median return slightly compared to 2019.
- Tax and expenses are higher than assumed in the 2019 review, reducing the median net return. These changes are primarily due to the higher investment return environment impacting tax and updated evidence on advice costs.
- The damage inflation assumption is the same as that in the 2019 review.

Figure 2 Impact on median net real return due to changes since 2019 review



Glossary

Asset portfolio – a portfolio of financial assets in which a claimant's lump sum is held. Includes both an invested portfolio and a cash reserve.

Award / Settlement – the total compensation paid to a claimant as a lump sum and/or PPO, noting that most are not formally 'awarded' but are agreed through the claims process.

Cash reserve – the cash held by claimants separate to their invested portfolio to meet their short- to medium-term needs.

2023 Call for Evidence – the Call for Evidence 'Exploring the option of a dual/multiple rate' issued on 17 January 2023.

2024 Call for Evidence – the Call for Evidence 'Setting the Personal Injury Discount Rate' issued on 16 January 2024.

Calls for Evidence – the 2023 Call for Evidence and 2024 Call for Evidence.

CLA – Civil Liability Act 2018 (which amended the Damages Act 1996).

Claimant outcomes – the likelihood that for a given set of assumptions, a claimant will receive sufficient compensation and if not, the extent of potential under- or over-compensation.

Core claimant types – three core claimant groups (20-, 40- and 60-year) covering key claimant characteristics, which are used in the analysis to highlight potential outcomes for different types of claimants.

CPI – Consumer Prices Index as published by the Office for National Statistics, which measures the prices for goods and services over time.

Damages – financial payments made to compensate a claimant for losses incurred as a result of an injury or illness for which another is responsible.

Damage inflation – the rate at which the cost of each head of loss increases over the term of the claim due to inflation. Different rates of inflation will be relevant for each head of loss. Damage inflation can differ from inflation measured using the CPI.

Damage profile – the change in annual sums needed by claimants to meet their spending needs, adjusted for the impact of damage inflation.

Discount rate – the rate used to calculate the present value of a payment to be made in the future. Usually expressed as a percentage rate per annum.

Diversified portfolio – an investment portfolio in which the funds are invested in a broad range of underlying assets.

Dual or multiple rates – when there are two or more rates for the PIDR, with different rates applying to losses split by term or by heads of loss.

Expenses – the relevant fees, including VAT where appropriate, experienced by the claimant and to be taken into account when setting the PIDR. These cover financial adviser fees, fund manager fees and other fees or costs, such as custody, transaction, fund administration and platform fees. They may be regular or one-off costs.

Full compensation – the funds required to ensure a claimant's award will meet their assessed needs over the settlement term and are fully exhausted at the end of the term.

GAD – the Government Actuary's Department, who have provided analysis and technical advice to the Expert Panel.

Head of loss – a category of compensation awarded to a claimant. Typically, a settlement will comprise of a number of such categories.

Invested portfolio – the proportion of the lump sum that is invested in financial assets, either directly or through funds, and specifically excluding any cash reserve.

Investment strategy – the allocation of the invested portfolio and cash reserve across available asset classes.

Loss / Losses – financial losses (e.g. loss of earnings) and additional costs (e.g. costs of medical treatment) arising as a result of an injury or illness.

Lump sum – in this context the amount paid to an injured claimant to represent the present value of future losses, excluding: any past losses, general damages, accommodation, PPOs and any other heads of loss not subject to the PIDR.

Median – the mid-point of a set of outcomes, such that 50% of the expected outcomes are greater, and 50% are lower than this point.

MoJ – Ministry of Justice.

Net real return – in this context, it is the annualised investment return net of tax, expenses and damage inflation. Also referred to as a net real investment return.

Normal life expectancy – the estimated life expectancy of average members of the population alive today, provided in statistics from the Office for National Statistics (ONS).

Ogden Tables – a set of tables used to calculate lump sum awards for personal injury cases in the United Kingdom. Prepared by an inter-disciplinary working party.

ONS – Office for National Statistics

Over-compensation – occurs when claimants receive more than sufficient compensation.

Personal Injury Discount Rate (PIDR) – the discount rate set by the Lord Chancellor to calculate the lump sum awards to claimants in respect of future losses in an injury or accident settlement.

Periodic Payment Order (PPO) – an award or element of an award in which a claimant is provided for via a future series of regular payments, typically monthly or annually, rather than a lump sum.

Risk – for the purpose of this report, risk generally means the chance that a claimant's award is exhausted before they have been able to meet all of their corresponding needs.

Recipient / Claimant – the individual who has been injured (or their representatives), when another party is responsible, and who seeks redress through a claim.

Schedule of Loss – the list of losses an individual is being compensated for, typically broken down into sections as heads of loss.

Sufficient compensation – occurs when all of a claimant’s future needs are met, and no more, through a combination of the lump sum award and net investment returns.

Under-compensation – occurs when claimants receive less than sufficient compensation.

Term – the period over which a claimant’s damages are expected to extend.

Annexure:

Personal Injury Discount Rate – Analytical Report

Government Actuary's Department advice to the Expert Panel

Government Actuary's Department

Personal Injury Discount Rate – Analytical Report

Government Actuary's Department advice to the Expert Panel

25 September 2024

Paul Butcher FIA

The Government Actuary's Department is proud to be accredited under the Institute and Faculty of Actuaries' Quality Assurance Scheme. Our website describes the standards we apply.

Contents

1. Executive summary

Background

1.1 An Expert Panel ('the Panel') has been formed to provide advice to the Lord Chancellor for the Personal Injury Discount Rate (PIDR). To supplement their expert knowledge and information from two Calls for Evidence issued by the Ministry of Justice (MoJ), the Panel has commissioned analysis from the Government Actuary's Department (GAD).

1.2 The Panel has requested analysis to support their decisions on appropriate assumptions, quantify claimant outcomes for different PIDRs, and inform their considerations around the adoption of multiple rates. This report provides our analysis and summarises the assumptions adopted.

Approach

1.3 The analytical approach followed has been to:

- **derive** the net median return for key claimant types, which if used as the PIDR would result in a 50% likelihood of them having exactly sufficient funds to meet their needs;
- **quantify** the range of 'outcomes' for key claimant types under different PIDRs, both under a single discount rate system and a dual discount rate system. These outcomes relate to the likelihood of claimants having at least sufficient funds to meet their needs and the extent of any shortfall or excess.

1.4 Underpinning our analysis are assumptions on the claimant types to be considered, investment strategy and returns, expenses, tax and damage inflation.

1.5 These assumptions have been set by the Expert Panel, with input from GAD and the MoJ where appropriate. A key input into this was evidence collected from stakeholders, including responses to the 2024 Call for Evidence.

1.6 The sensitivity of the analysis to alternative assumptions has also been assessed.

Claimant Types

1.7 The Panel defined a range of 'core' claimant types, which they believe enables them to consider outcomes for a significant proportion of personal injury claimants, who will receive a lump sum subject to the PIDR.

1.8 The key features of these are set out in Table 1:

Table 1: Assumed features of the three core claimant types

	Core claimant type		
	'20-year'	**'40-year'**	**'60-year'**
Investment term	20 years	40 years	60 years
Investment strategy	Cautious	Central	Less cautious
Lump sum size	£500k	£1m	£5m

1.9 As well as the above core claimant types, the Panel asked GAD to model what they believe to be plausible, so called, 'additional' claimant types. These include a claimant type with a 10 year investment term to illustrate the impact of the PIDR on those claimants with particularly short terms. These additional claimants are discussed further in Section 6.

Single rate analysis

Core claimant median net investment returns

1.10 Our analysis shows that the median net investment returns (median investment returns net of expenses, tax and damage inflation) for the core claimant types are within the range 0.7% and 1.4% p.a. shown in Table 2. This means that a PIDR of 0.7% (rounded to the nearest 0.1%) would give at least 50% likelihood of 100% compensation for all core claimants.

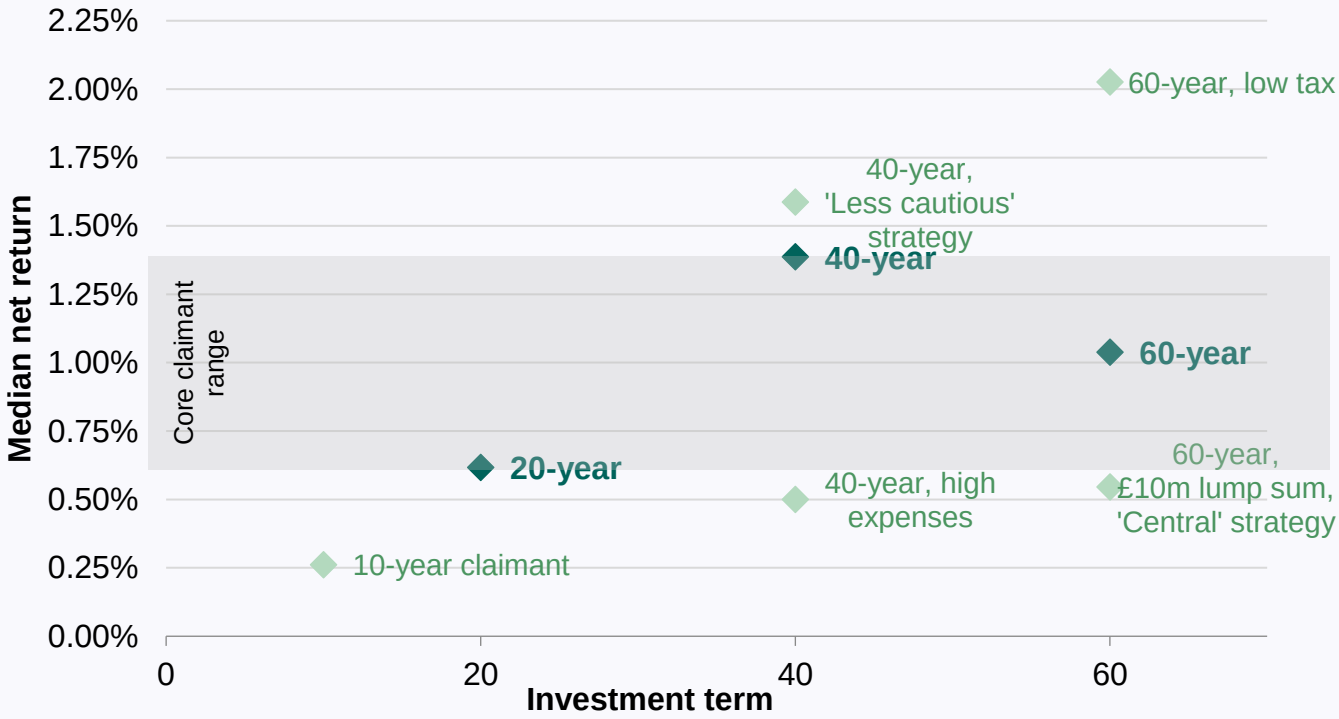
Table 2: Median net return for core claimant types

Claimant types	Investment return p.a. (a)	Expenses p.a. (b)	Tax p.a. (c)	Damage inflation p.a. (d)	Net return p.a. (a-b-c-d)
20-year	CPI+2.9%	0.9%	0.3%	CPI+1.0%	**0.7%**
40-year	CPI+3.5%	0.9%	0.2%	CPI+1.0%	**1.4%**
60-year	CPI+3.8%	0.6%	1.2%	CPI+1.0%	**1.0%**

Median net investment returns sensitivities

1.11 The sensitivity of the net median returns to alternative assumptions has been assessed as part of our analysis, as discussed in Section 6. A majority of the sensitivities produced fall within or above the core claimant range of 0.7% to 1.4% but the graph below highlights those key sensitivities that fall outside of this range.

Figure 1: Median net returns for key sensitivities outside of the core claimant range



1.12 The key scenario that falls below the range is the 10-year claimant, which has a net median return of 0.3%. However, it is worth noting that, due to the short term, the PIDR has a relatively low impact for the 10-year claimant, and the likelihood of having at least 90% compensation is above 75% for PIDRs up to 1.25%.

1.13 If a claimant is assumed to have significantly higher expenses or particularly high tax (due to a very large lump sum of £10m), then they would also have a net median return marginally below the core range. There are also scenarios which fall significantly above the range, for example for claimants that take on more investment risk or longer-term claimants who are able to incur lower tax charges.

Impact of economic uncertainty

1.14 The above net returns represent a best estimate (i.e. a 50% chance of being higher or lower) but are subject to economic uncertainty, and hence a claimant would expect to have an even chance of being under-compensated if the PIDR was set in line with their net return.

1.15 It is therefore important to understand the impact of this uncertainty on claimant outcomes, firstly by comparing the likelihood of achieving specified compensation levels, under various PIDRs.

1.16 Considering PIDRs set around the net return range of 0.7% to 1.4% (in 0.25% intervals), Table 3 shows the likelihood of each of the core claimant types being at least 100% or 90% compensated. The figures in **green** highlight those cases in which there is more than a 50% likelihood of claimants receiving the defined level of compensation and those in **red** highlight cases in which there is less than a 50% likelihood.

Table 3: Likelihoods of achieving at least 90% and 100% compensation levels

PIDR	Core claimant type					
	20-year		40-year		60-year	
	Likelihood of at least __ compensation					
	100%	90%	100%	90%	100%	90%
0.50%	55%	83%	76%	87%	64%	75%
0.75%	47%	78%	69%	83%	58%	70%
1.00%	40%	73%	63%	78%	50%	64%
1.25%	32%	67%	55%	72%	43%	57%
1.50%	25%	60%	48%	66%	36%	50%

1.17 It is also useful to consider the likelihood of significant under- and over-compensation when comparing various PIDRs. Table 4 below highlights the likelihood (expressed as a proportion of simulated outcomes) that under 90% of sufficient compensation is achieved (in **red**), alongside the likelihood that between 90% and 120% (in **green**) is achieved and over 120% is achieved (in **orange**).

1.18 This analysis suggests that, whilst a PIDR of 0.5% and below would minimise the risk of compensation below 90% for the 20-year claimant to around 15-20%, it would also lead to the 40-year claimant having around a 45% chance of receiving over 120% compensation. Alternatively, a PIDR of 1.25% would reduce the chance of the 40-year claimant receiving over 120% compensation to around 20-25% but would increase the risk of compensation below 90% for the 20-year claimant to around 30-35%.

Table 4: Likelihood of achieving various compensation levels

PIDR	Core claimant type								
	20-year			40-year			60-year		
	Likelihood of achieving a compensation level of…								
	Under 90%	90 to 120%	Over 120%	Under 90%	90 to 120%	Over 120%	Under 90%	90 to 120%	Over 120%
0.50%	17%	76%	7%	13%	42%	45%	25%	34%	41%
0.75%	22%	74%	5%	17%	45%	37%	30%	37%	33%
1.00%	27%	70%	3%	22%	48%	30%	36%	38%	26%
1.25%	33%	65%	2%	28%	50%	22%	43%	38%	19%
1.50%	40%	58%	1%	34%	51%	16%	50%	36%	14%

Multiple discount rates

1.19 Analytically speaking, it is relatively straightforward to establish multiple rates. The potential benefits of being able to more tailor the rate to claimant groups, however, need to be weighted up against the magnitude of those benefits and the practical implementation considerations.

1.20 Dual rates by term of award can be utilised to reduce the disparity of expected median outcomes between claimants of different terms. In particular, they can improve the probability of at least sufficient (100%) compensation for shorter term claimants, which is difficult to achieve on a single rate without leading to significant over-compensation for a majority of claimants. However, it is worth noting that this benefit is lessened when considering the impact on achieving at least 90% sufficient compensation, as shorter term claimants already have a high probability of achieving this on a single discount rate.

1.21 Dual rates by heads of loss can be utilised to provide those with different levels of earnings-related damages to those assumed with a more appropriate level of compensation.

2. Introduction

Background

2.1 This report has been commissioned by the Expert Panel ('the Panel'), which was set up under the requirements of the Damages Act 1996 (as amended by the Civil Liability Act 2018) ('the Act'), to review the Personal Injury Discount Rate (PIDR) in line with the process and rationale described below.

2.2 Awards of damages for personal injury claims are intended to provide claimants with full compensation for all expected losses and costs associated with their injuries. Where relevant future damages take the form of a lump sum, the settlement is calculated using the PIDR.

2.3 Schedule A1 to the Act describes the way in which the PIDR is to be set by the Lord Chancellor. It stipulated the requirement for the Lord Chancellor to consult the Government Actuary and HM Treasury at the first review, which was conducted between March and July 2019. Following the review, the Lord Chancellor set the PIDR at -0.25%[1].

2.4 The Act also requires subsequent reviews to commence within five years following the last review and for these to be undertaken by the Lord Chancellor following consultation with HM Treasury and an 'Expert Panel' to be chaired by the Government Actuary.

2.5 In line with the above, the Panel was formed on 21 July 2023 to begin considering the next PIDR review, in preparation for their consultation with the Lord Chancellor, which commenced on 15 July 2024.

2.6 The consultation requires the Panel to provide options for setting the PIDR, with varying degrees of confidence, to the Lord Chancellor. These options will be informed by members' expert knowledge and any additional insight gained from the activities of the Panel.

2.7 The Act states that the Panel should be provided with the resources to exercise its functions. As such, supported by the Ministry of Justice (MoJ), the Panel has commissioned the Government Actuary's Department (GAD) to provide analysis to assist with its provision of options to the Lord Chancellor.

Scope

2.8 This report sets out the output of the analysis commissioned by the Panel, to inform the range of potential outcomes for different groups of personal injury claimants under various PIDRs. This includes the impact of economic uncertainty to which claimants are exposed, as well as other uncertainty over the assumptions adopted.

2.9 It also summarises the methodology and assumptions which underpin the analysis, and which were set by the Panel, with input from GAD and the MoJ where appropriate.

[1] The Damages (Personal Injury) Order 2019 (legislation.gov.uk)

2.10 Assumptions have been set relating to the investment portfolio, tax and expense deductions, damage inflation and lump sum size. A key input into this was evidence collected from stakeholders, including responses to the 2024 ‘Setting the Personal Injury Discount Rate: A Call for Evidence’[2] (referred to as the 2024 Call for Evidence in this report).

2.11 Whilst this evidence has been carefully considered, there is a recognition that there are limitations around the evidence available and that each claimant is different, and so judgement is required in a number of areas on which assumptions are most appropriate.

2.12 In order to understand the possible extent of these uncertainties, the Panel has requested sensitivity analysis of the results based on alternative assumptions.

2.13 There is also uncertainty relating to future events, such as changes in the tax regime, which means that the analysis will only represent outcomes under one possible view of the future. This report illustrates ranges and uncertainties of outcomes, and the limitations of the approach, which the Panel will need to keep in mind when considering the options they put forward to the Lord Chancellor.

2.14 Finally, it should be noted that the analysis contained in this report is just one component of the wider evidence base the Panel has available to inform their advice to the Lord Chancellor.

2.15 The analysis in this report has been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK. This report has been prepared on the expectation that it will form part of the Panel’s response to the Lord Chancellor and will be made public alongside an Expert Panel report. The Panel has agreed that it can also be considered by HM Treasury as part of their response to the Lord Chancellor.

2.16 Other than the Panel, the Ministry of Justice and HM Treasury, no person or third party is entitled to place any reliance on the contents of this report and GAD has no liability to any person or third party for any act or omission, taken either in whole or part on the basis of this report.

[2] https://www.gov.uk/government/calls-for-evidence/setting-the-personal-injury-discount-rate

Structure

2.17 The remainder of this report is structured as follows:

- Section 3 discusses the characteristics of the different types of personal injury claimants our analysis is based on
- Section 4 describes and derives the net investment return assumption for each of the core claimant types
- Section 5 discusses the range of compensation levels for different claimant types, and the likelihoods associated with these under various PIDRs
- Section 6 shows sensitivity analysis and impact of longevity risk.
- Section 7 shows claimant outcomes under two possible dual rate approaches, by term of award and by heads of loss
- Annex A describes the assumptions used in our analysis and how they were derived
- Annex B describes the calculation methodology employed in our analysis
- Annex C provides further details on the sensitivity analysis in Section 6
- Annex D provides further tables and charts on breakdowns of compensation levels for the core claimants under a range of PIDRs
- Annex E describes the analysis undertaken on defined contribution master trust investment strategies

3. Claimant types

Background

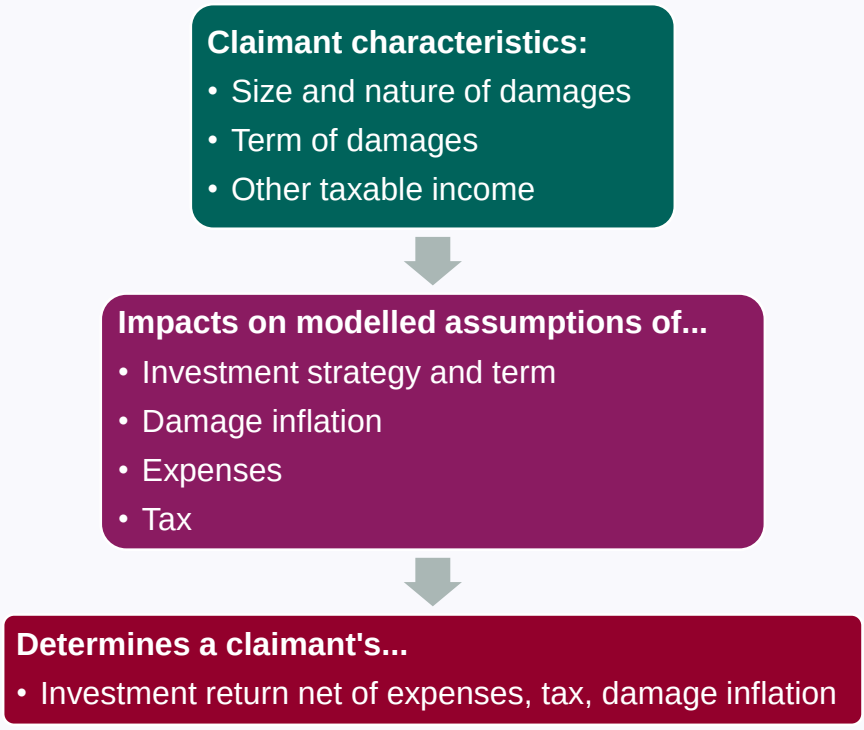
3.1 All personal injury award claimants have different characteristics. For the purpose of our analysis, the ones that are key are the size, nature[3] and term[4] of damages, and the existence of any other taxable income.

3.2 How a claimant's characteristics are expected to impact on the net investment return required for them to meet their needs is through:

- the nature of the damages, impacting on the assumptions for damage term and inflation;
- the term of the damages, impacting on the investment strategy adopted;
- the size and term of the damages, impacting on the level of expenses incurred; and
- the size and the term of the damages, as well as other taxable income, impacting on the level of tax incurred.

3.3 Claimant characteristics and external factors, such as the tax regime and investment cost environment, also impact on their choice of investment strategy and approach to tax management. These interactions are discussed further in the appropriate assumption setting sections and Figure 2 shows the flow of how they are modelled in this analysis.

Figure 2: The flow of the modelling to determine net investment returns



[3] For example, the future level of care costs, loss of earnings, aids and equipment, etc., and whether these are increasing (and if so, linked to what type of inflation), decreasing or level

[4] For example, whether damages are payable for life or until retirement age etc.

3.4 In practice, each personal injury claimant is different, meaning that a single PIDR cannot be expected to ensure sufficient compensation for all claimants without a high likelihood of significant over-compensation for a majority of claimants. Therefore, the Panel has requested that we present analysis for a variety of claimants in order to illustrate a range of potential claimant outcomes.

3.5 We set out below the range of claimants the Panel has agreed is reasonable to consider, when looking at outcomes under different PIDRs. These are broken down into two categories – 'core' claimant types and 'additional' claimant types.

Core claimant types

3.6 We consider the 'claimant universe' as the entire set of personal injury claimants who will receive a lump sum calculated using the PIDR. In this report, the lump sum refers to the amount of the award subject to PIDR as opposed to the total award size. Given the large number of claimants, each with different characteristics, attempting to model the entire claimant universe would not be feasible.

3.7 The Panel has asked GAD to model three 'core' claimant types that between them are expected to reflect a large proportion of the claimant universe. Each of these has realistic, internally consistent assumed features, of which the key ones are summarised in Table 5 below.

3.8 Further details on the rationale for arriving at these core claimant types are set out in Annex A: Assumptions.

Table 5: Assumed features of the three core claimant types

	Core claimant type		
	20-year	**40-year**	**60-year**
Investment term	20 years	40 years	60 years
Investment strategy	Cautious	Central	Less cautious
Lump sum size	£500k	£1m	£5m

3.9 Of the three core types, the analysis of the 2024 Call for Evidence responses (as set out in Annex A) suggested that the term, investment strategy and lump sum size features implied by the '40-year' claimant, were representative of a 'typical' claimant within the claimant universe. A smaller lump sum would be more representative of an 'average' claimant weighted by number of claims, but, as shown by the sensitivity analysis, assuming a smaller lump sum (and keeping everything else the same) is unlikely to have a material impact on the conclusions from the analysis.

3.10 Furthermore, the 2024 Call for Evidence suggested that presenting the '20-year' and the '60-year' claimants represented a reasonable range of terms, investment strategies and lump sum sizes.

Additional claimant types

3.11 As well as the above core claimant types, the Panel has asked GAD to model variations of these, reflecting what they believe to be less common, but plausible, so called ‘additional’ claimant types.

3.12 It is not possible to model every possible claimant type outside of the ‘core’ range and therefore some claimants have been ‘grouped’ together. For example, those with shorter investment terms than 20 years have been considered to be represented by an additional claimant type with a term of 10 years.

3.13 Further details on the rationale for arriving at these additional claimant types are set out in Annex A.

3.14 The analysis of their outcomes is discussed in Section 6. In addition, in Section 7, when considering a dual PIDR, we also set out its impact on a 10-year additional claimant in order to illustrate the extent of any reduction in disparities between claimants.

4. Introducing the discount rate

Background

4.1 We now introduce the concept of discount rates for each of the core claimant types discussed in Section 2 above.

4.2 A claimant's lump sum is calculated by applying a discount rate (the PIDR) to their expected future damages to convert them into a value in 'today's' terms.

4.3 The Act states that the PIDR must be set at the rate that *"…a recipient of relevant damages could reasonably be expected to achieve if the recipient invested the relevant damages…"* subject to the claimant's needs being fully met and no fund remaining at the end of their lifetime.

4.4 It also states that the Lord Chancellor must *"…make such allowances for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate."*

4.5 It follows that if a claimant earns an investment return net of expenses, tax, and damage inflation ('net investment return') on their lump sum that is equal to the PIDR used to calculate it, and all other assumptions are borne out in practice, then they will receive 'sufficient compensation'.

4.6 By 'sufficient compensation' we mean that all of a claimant's future needs are met, and no more, through a combination of the lump sum award and net investment returns.

4.7 In this section, we set out the median net investment returns implied for each core claimant type, i.e. the level of return that a claimant is forecast to have an equal chance of exceeding or not exceeding.

4.8 These returns should be the starting point of the Panel's considerations when forming their advice on the PIDR. This is because if the PIDR is set equal to the median net return, then there is a 50% chance that claimants will receive at least sufficient compensation (subject to all other assumptions being borne out in practice).

4.9 To determine the median net investment return for each core claimant type, several additional assumptions are required, which have been set by the Panel. These are described in the summary of Annex A, and have all been chosen to be to be consistent with the core claimant types.

4.10 We do not consider the impact of economic uncertainty in this section – that is the uncertainty surrounding investment returns and inflation over a claimant's lifetime and how any mismatch between this and the PIDR rate impacts on the likelihood of sufficient compensation being achieved. This is considered in Section 5.

4.11 Furthermore, in this section we do not consider other risks that claimants may face. In particular:

- 'Longevity risk' - the risk that a claimant lives longer or shorter than assumed
- 'Needs risk' - the risk that a claimant's needs will change over time

4.12 These factors do not form part of the PIDR setting process, so therefore are not considered as part of our core modelling. However, in Section 6 we include commentary on these risks as requested by the Panel.

Expressing the PIDR

4.13 Throughout this report, we express the PIDR as a single real annual rate, e.g. '-0.25%' as it is currently. This is because we assume the rate represents the excess of a claimant's annual investment return over expenses, tax, and damage inflation.

4.14 In formulaic terms, the net investment return is expressed as:

$$Net\ investment\ return\ =\ (Gross)\ Investment\ return - Expenses - Tax - Damage\ inflation$$

4.15 Because both investment return and damage inflation may be expressed with reference to an inflation index such as the Consumer Price Index (CPI) e.g. 'CPI+1% p.a.', deducting damage inflation from investment return nets out the impact of CPI. For example, if annual investment returns are assumed to be CPI+3% and annual damage inflation is assumed to be CPI+1%, then annual investment returns net of damage inflation would be 2%.

4.16 Expenses and tax are expressed consistently with an investment return and can be considered as the proportion of the investment return lost to tax and expenses. For example, if annual investment return is assumed to be 5% and 1% of that return goes to pay expenses and 0.5% of that return goes to pay tax, then an annual return net of tax and expenses is 3.5%.

Median net returns – core claimants

4.17 Table 6 below shows the assumptions utilised to determine the median net returns for each of the core claimant types, which are discussed in more depth in Annex A. These are consistent with the Panel's view that:

- Terms from 20 to 60 years would inform outcomes for a significant majority of claimant terms.
- Lump sums from £500k to £5m would inform outcomes for a significant majority of claimant lump sums, whilst also noting that there is a large number of claimants with smaller lump sums (considering lump sums less that £500k is unlikely to impact on the analysis presented).
- An overall portfolio would likely consist of an invested portfolio with an agreed investment strategy and a separate cash holding, often referred to as a 'cash reserve'. This cash reserve is expected to broadly reflect the assumption that claimant's hold around 3 years' worth of damage payments. Both of these are expected to interact with the term, since a longer term enables more scope to take on further investment risk and 3 years' worth of cash is a smaller proportion of the lump sum for a longer term.
- Other taxable income between £7k and £30k p.a. is reasonable and that those with smaller lump sums are more likely to have higher income (through being able to work or have other income, such as pensions).
- It is reasonable to assume expenses only apply to the invested portfolio and are zero for the cash reserve proportion (the expense figures in Table 6 are the resulting overall expenses impact, so the expenses on the invested portfolio only are higher than these).

- Damage inflation of CPI+1% is a reasonable assumption to apply across the claimant types considered.

Table 6: Core claimant assumptions

Claimant type	Term (years)	Lump sum size	Investment strategy	Cash reserve (% of portfolio)	Other taxable income p.a.
20-year	20	£500k	Cautious	30%	£30k
40-year	40	£1m	Central	15%	£7k
60-year	60	£5m	Less cautious	10%	£7k

Claimant type	Investment return p.a.	Expenses p.a.	Tax p.a.	Damage inflation p.a.
20-year	CPI+2.9%	0.9%	0.3%	CPI+1.0%
40-year	CPI+3.5%	0.9%	0.2%	CPI+1.0%
60-year	CPI+3.8%	0.6%	1.2%*	CPI+1.0%

** It is important to note the particular uncertainty around this 1.2% tax deduction assumption for the 60-year claimant type with a £5m lump sum. It is significantly higher than for the other claimant types because the larger lump sum is assumed to generate much more taxable income. However, in practice, the level of tax could conceivably be lower given that further tax management strategies could be employed. This is discussed further in the sensitivity analysis in Section 6.*

4.18 The median net return is calculated as follows and is summarised for each claimant type in Table 7 below (how median returns are determined is discussed in Annex B: Methodology):

$$\begin{aligned} &Median\ net\ return \\ &= Median\ gross\ investment\ return - Expenses - Tax - Damage\ inflation \end{aligned}$$

Table 7: Median net return for core claimant types

Claimant Type	Median net return p.a.
20-year	0.7%
40 year	1.4%
60 year	1.0%

4.19 The median net return for the 40-year claimant type is 1.4% p.a. If the PIDR were set at 1.25%[5], and all other assumptions are borne out in practice, this type of claimant would have more than a 50% chance of achieving at least sufficient compensation.

4.20 However, because the 20-year and 60-year claimant types have lower median net returns of 0.7% p.a. and 1.0% p.a. respectively, their chances of achieving at least sufficient compensation under a PIDR of 1.25% would be less than 50%.

[5] Assuming PIDR is set at a 0.25% increment, albeit this is not required in legislation

4.21 Alternatively, under a PIDR of 0.5%, all core claimant types would have a greater than 50% chance of achieving at least sufficient compensation, but this would be significantly higher than 50% for the 40-year claimant in particular.

Median net returns – differences

4.22 In Figure 3 below, we quantify how differences in the assumptions set out in Table 6 contribute to the changes in the median net return, illustrating which it is most sensitive to.

4.23 The green bars show the **median net return** for each of the three core claimant types. The intermediate bars attribute the differences in these returns to:

Changes in assumed:

- Investment strategy
- Investment term
- Lump sum size
- Other taxable income of each claimant type

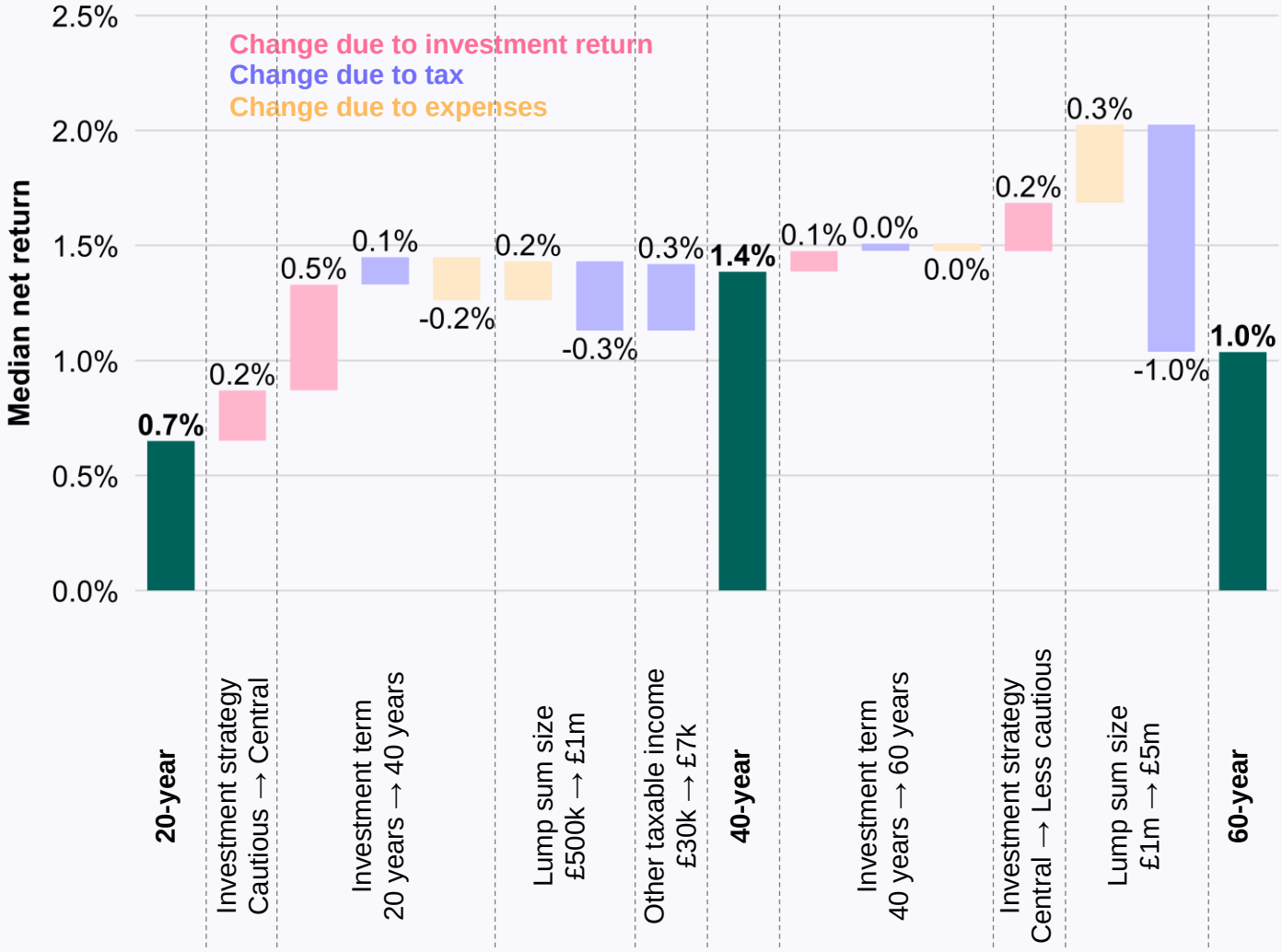
separated by the dashed lines.

And to changes in assumed:

- Investment returns (higher investment returns implies a *higher* net return)
- Tax (higher tax implies a *lower* net return)
- Expenses (higher expenses implies a *lower* net return)

identified by the coloured intermediate bars.

Figure 3: Factors contributing to differences in core claimant median net returns



4.24 The two key points to highlight are: the high tax costs for the 60-year claimant with a large lump sum, and the large difference in median net returns between the 20-year and 40-year claimants, discussed further below.

4.25 Starting from the left-hand side of the chart and moving from the 20-year to the 40-year claimant, the assumption change with the biggest impact is the increase in the investment term. This increases **investment returns** by 0.5% p.a. on the central investment strategy (having already changed from the cautious strategy in the first step of the chart). This is because the 40-year claimant is assumed to hold a lower proportion of their lump sum in cash (through the cash reserve, which is discussed in the 'Investment strategy' section of Annex A), which means there is a higher proportion held in higher returning assets. This is more material than the move from a cautious to a central investment strategy for the invested portfolio (0.2% p.a. impact).

4.26 Changes due to **tax costs** broadly net off, with a smaller proportion of the lump sum assumed to be in a tax-efficient ISA arrangement (0.2% p.a. impact, with the larger lump sum partially net off by a longer investment term) and a lower level of other taxable income (0.3% p.a. impact) assumed.

4.27 Changes due to **expenses** also broadly net off, through a combination of expenses increasing as a result of a larger proportion of the lump sum being in the invested portfolio (0.2% p.a. impact) and expenses decreasing as a proportion of the lump sum through having a larger lump sum to invest (0.2% p.a. impact).

4.28 Towards the right of the chart and moving from the 40-year to the 60-year claimant, the assumption change with the biggest impact is the increase in the lump sum size. This increases **tax costs** by 1.0% p.a. which more than offsets the 0.3% p.a. decrease through lower **expenses**. The lower cash reserve and move to a less cautious investment strategy increase the **investment returns** by 0.3% p.a. This highlights that, when considering claimant groups with lump sums significantly larger than £1m, the assumed approach to tax is highly material and there is significant uncertainty in that assumption (as discussed further in Section 6).

5. Impact of economic uncertainty

Background

5.1 The previous section focused on the median net investment return for each core claimant type. If the PIDR is set equal to a claimant's median net return and they go on to achieve this return each year, then they will receive sufficient (100%) compensation (subject to all other assumptions being borne out in practice).

5.2 In practice, uncertainty exists around future economic conditions and investment returns. In our modelling, the median return means that there is assumed to be a 50% chance that actual investment returns over the whole term are higher than this, and a 50% chance they are lower. In reality, the investment returns will likely result in a different pattern, but we believe that our model gives a reasonable assessment of the probability of different economic scenarios.

5.3 It is important that we consider the extent of this economic uncertainty and what this means for the resulting range of compensation levels for different claimant types, and the likelihoods associated with these under various PIDRs. It is, however, important to note that the analysis focusses on the comparisons between scenarios and that the figures presented in this section would be spurious if considered to the nearest percentage. The remainder of this section covers this in detail.

Likelihood of sufficient compensation

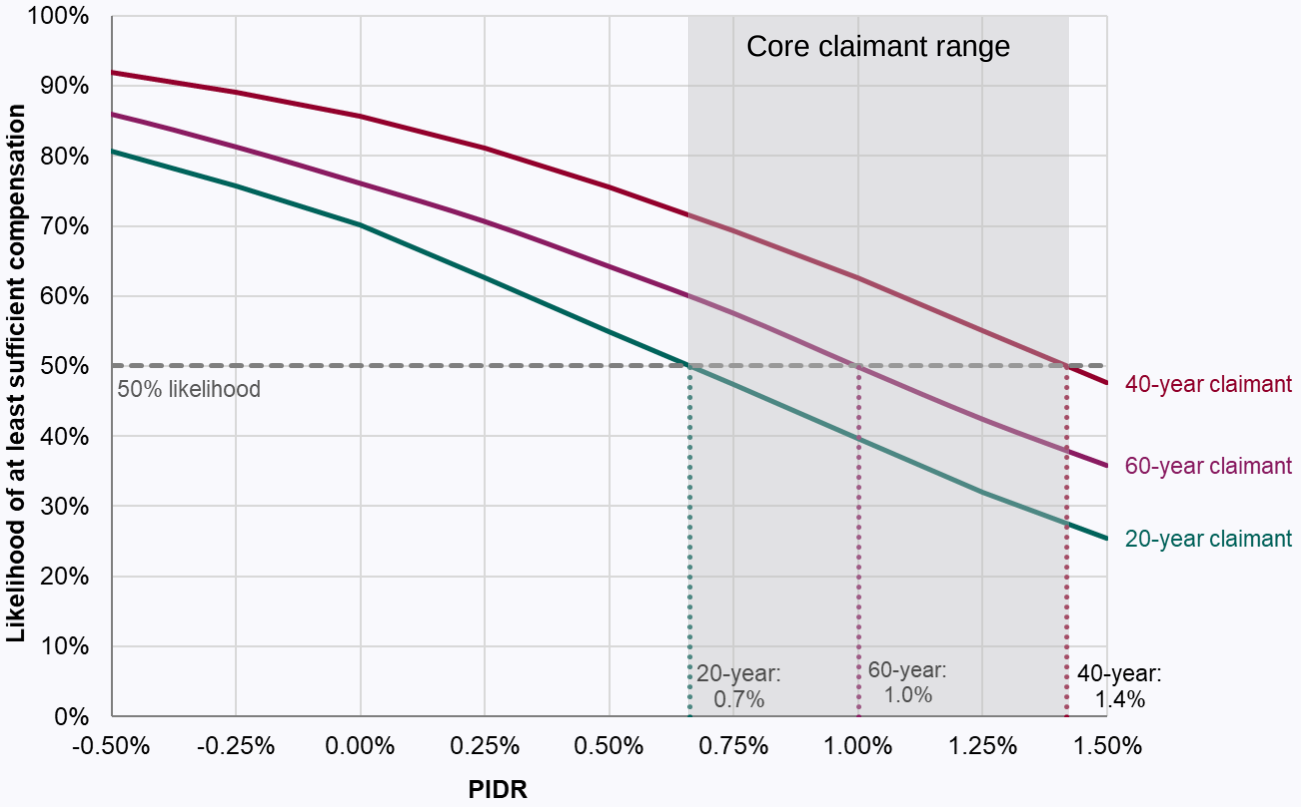
5.4 We begin by setting out in Figure 4 and Table 8 overleaf the likelihood that the core claimant types achieve at least sufficient compensation under different PIDRs.

5.5 We do this by projecting a claimant's fund value over their investment term under a large number of economic simulations and considering the proportion of these in which the remaining fund is positive at the end of the term. This is equivalent to the proportion of simulations where the net investment return is, on average, more than the associated PIDR. Investment returns and CPI are varied with each economic simulation, whereas the deductions for expenses, tax, and damage inflation are unchanged. The methodology is discussed further in Annex B.

5.6 The points shown by the dotted lines in Figure 4 show, for each core claimant type, the discount rates at which the likelihood of at least sufficient compensation is 50%. This occurs when the PIDR equals the median net investment returns set out earlier in Table 7. This shows that:

- For a given PIDR, the 40-year claimant has the highest probability of being at least sufficiently compensated.
- The 60-year claimant has lower probabilities than the 40-year claimant due to the impact of the high tax drag assumption. The uncertainty around the tax drag assumption may mean that the likelihood of achieving at least sufficient compensation could reasonably be greater than shown.
- The 20-year claimant has the lowest probabilities due to the lower expected returns from a larger cash reserve and the more cautious assumed investment strategy.

Figure 4: Likelihood of at least sufficient compensation under different PIDRs



5.7 Table 8 below draws out the likelihoods of at least sufficient compensation under PIDRs at 0.25% increments between 0.5% (where all three core claimant types are expected to have more than 50% likelihood) and 1.5% (where all three have less than 50% likelihood).

5.8 It also shows the likelihoods under the current PIDR of -0.25% as a comparator. Figures in **green** denote scenarios in which claimants are expected to have more than 50% likelihood and figures in **red** denote those in which claimants are expected to have less than 50% likelihood of at least sufficient compensation.

Table 8: Likelihood of at least sufficient compensation under different PIDRs

	Likelihood of at least sufficient compensation		
PIDR	**Core claimant type**		
	20-year	**40-year**	**60-year**
-0.25%	76%	89%	81%
0.50%	55%	76%	64%
0.75%	47%	69%	58%
1.00%	40%	63%	50%
1.25%	32%	55%	43%
1.50%	25%	48%	36%

Likelihood of at least 90% compensation

5.9 In the last sub-section, we considered the likelihood of the different claimant types achieving at least sufficient compensation, i.e. sufficient to meet at least 100% of a claimant's financial needs. Next, we consider the likelihood of avoiding significant under-compensation, which the Panel has defined as being 90% compensated.

5.10 Figure 5 and Table 9 below show the likelihood of achieving at least 90% compensation, i.e. at least 90% of a claimant's needs are met, under different PIDRs for each core claimant type. Table 9 draws out the information from Figure 5 (consistent with the information in Table 8). They show that:

- At PIDRs within the core claimant range of 0.7% to 1.4%, all three core claimants are expected to have a relatively high likelihood of at least 90% compensation.
- For a given PIDR, the 20-year claimant has a much closer probability to a 40-year claimant of being at least 90% compensated compared to the probability of being at least 100% compensated. A shorter investment term and a more cautious investment strategy means the risk of experiencing significantly lower returns than expected over the term and being significantly under-compensated is lower. The narrower range of outcomes for the 20-year claimant discussed further in the next sub-section and in the investment term section of Annex A (in the 'Materiality of term on PIDR' sub-section).
- For a given PIDR, the 60-year claimant now has the lowest probability of being at least 90% compensated, due to the greater range of outcomes from taking more investment risk for a longer period of time.

Figure 5: Likelihood of at least 90% compensation under different PIDRs

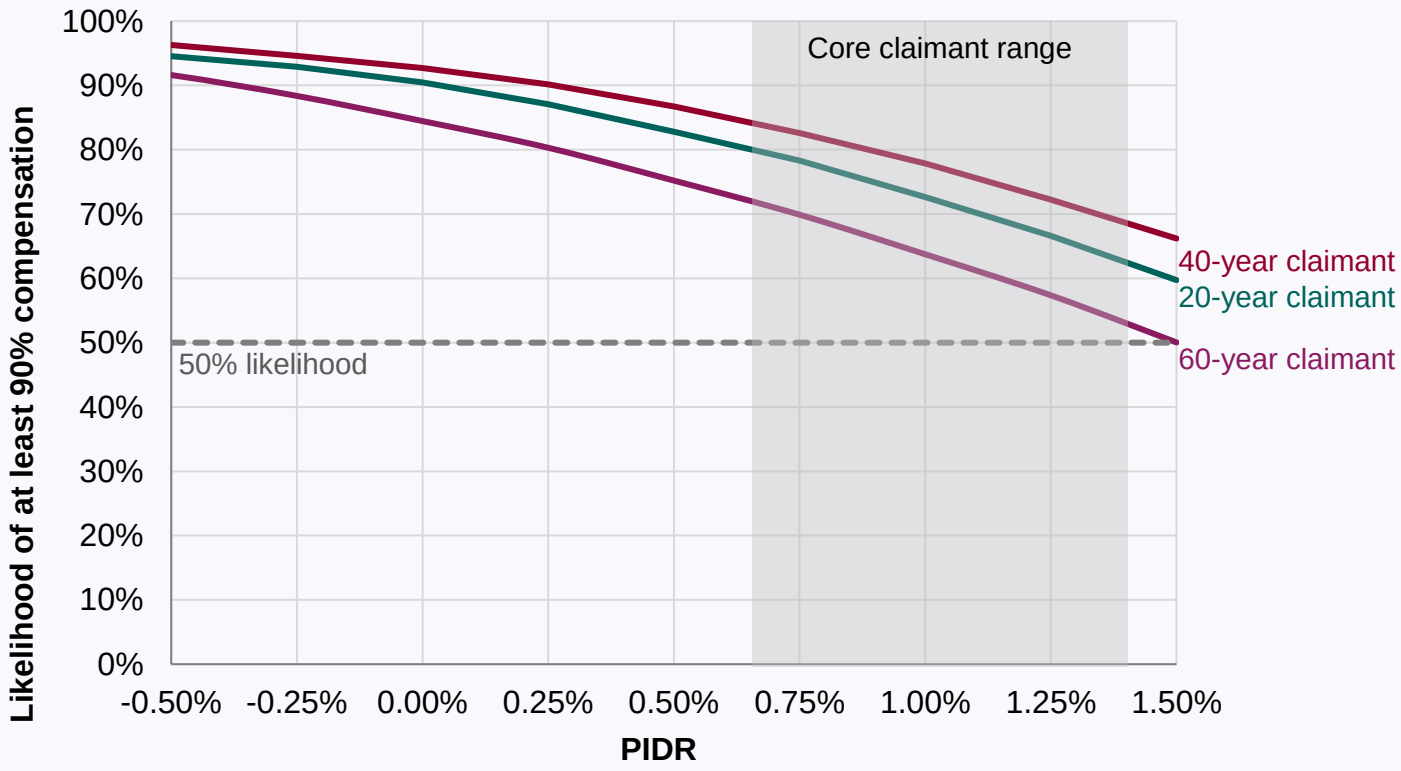


Table 9: Likelihood of at least 90% compensation under different PIDRs

PIDR	Likelihood of at least 90% compensation		
	Core claimant type		
	20-year	40-year	60-year
-0.25%	93%	95%	88%
0.50%	83%	87%	75%
0.75%	78%	83%	70%
1.00%	73%	78%	64%
1.25%	67%	72%	57%
1.50%	60%	66%	50%

Impact of different PIDRs on compensation levels

5.11 So far in this section, we have considered the likelihood of the different claimant types achieving at least sufficient (100%) and at least 90% sufficient compensation.

5.12 This sub-section looks at this in more detail. In particular, it considers ranges of over-compensation and under-compensation, and the likelihoods associated with these under different PIDRs. The Panel have agreed that considering compensation up to 120% is reasonable, before the compensation can be considered as significant over-compensation.

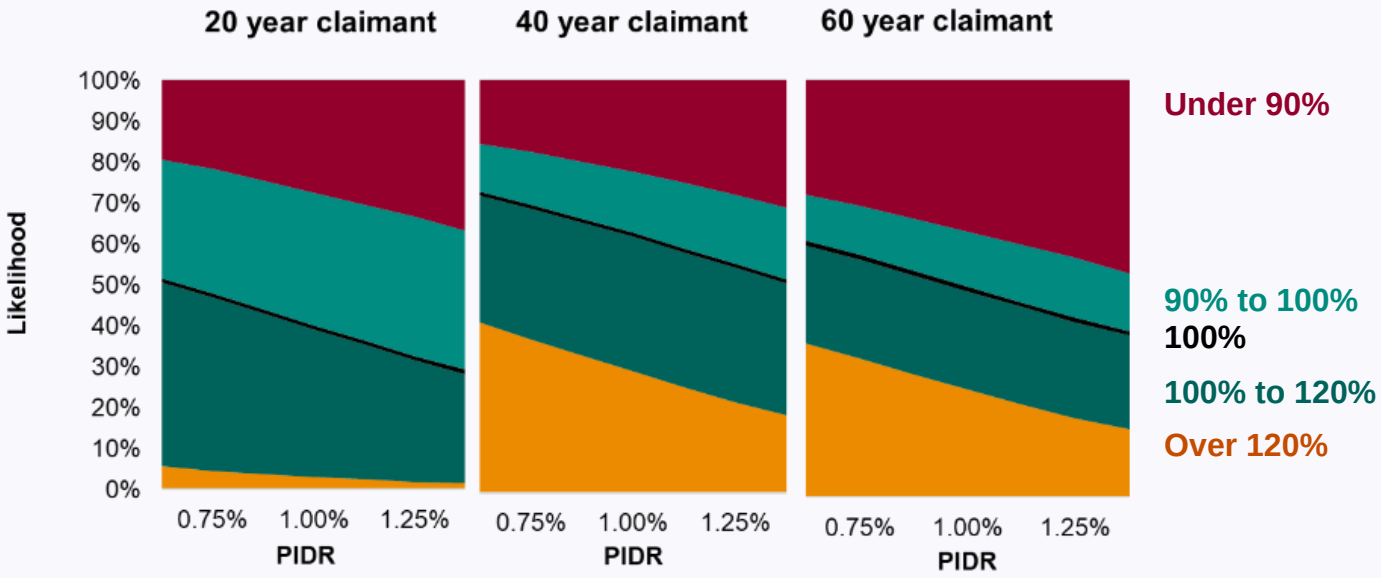
5.13 A summary of our analysis is illustrated in the Figures 6 and Table 10 below for each core claimant. They illustrate the impact of both investment term and investment strategy on the range of outcomes. In particular, they show that:

- For all illustrated PIDRs, all claimants retain a chance of significant over-compensation (above 120%) and significant under-compensation (below 90%).
- For a given PIDR, the 20-year claimant is mostly likely to be undercompensated but this changes to the 60-year claimant if considering the likelihood of significant under-compensation (below 90%).
- For a given PIDR, the 60-year claimant has the widest range of outcomes, while the 20-year claimant has the highest likelihood of compensation being between 90 and 120%. A more cautious investment strategy and shorter term gives a narrower range of outcomes.

5.14 Further charts and tables have been provided in Annex D to show this analysis in more detail and in alternative formats.

5.15 Figure 6 shows the probability ranges of compensation over 120% (in **orange**), compensation between 100% and 120% (in **dark green**), between 90% and 100% (in **light green**) and under 90% (in **red**), for a range of PIDRs between 0.7% and 1.4%, for the core claimants in turn (a wider range of PIDRs are shown in Annex D).

Figure 6: Likelihood of over/under compensation under differing PIDRs for the 20-year, 40-year and 60-year claimants



5.16 Table 10 draws out from the graphs above (and Annex D) the likelihood (expressed as a proportion of simulated outcomes) of achieving under 90% compensation (in **red**), between 90% and 120% (in **green**) and over 120% (in **orange**) for a wider range of PIDRs.

Table 10: Likelihood of achieving various compensation levels

PIDR	Core claimant type								
	20-year			40-year			60-year		
	Likelihood of achieving a compensation level of…								
	Under 90%	90 to 120%	Over 120%	Under 90%	90 to 120%	Over 120%	Under 90%	90 to 120%	Over 120%
-0.25%	7%	73%	20%	5%	26%	69%	12%	25%	64%
0.50%	17%	76%	7%	13%	42%	45%	25%	34%	41%
0.75%	22%	74%	5%	17%	45%	37%	30%	37%	33%
1.00%	27%	70%	3%	22%	48%	30%	36%	38%	26%
1.25%	33%	65%	2%	28%	50%	22%	43%	38%	19%
1.50%	40%	58%	1%	34%	51%	16%	50%	36%	14%

5.17 As mentioned previously, in carrying out this analysis, investment returns and CPI are varied with each economic simulation whereas the deductions for expenses, tax, and damage inflation are unchanged.

5.18 In practice, higher/lower investment returns would likely result in higher/lower expenses and tax. For example, if the investments are providing higher returns, this could lead to more tax than allowed for in the modelling, leading to a lower level of over-compensation. The inverse is true, i.e. if investments are providing lower returns, then tax would be reduced. This has the potential to materially impact on our analysis of the 60-year claimant's outcomes, due to the higher level of expected tax assumed.

5.19 These projections also assume that claimants hold a static investment portfolio (representing the average portfolio held over the term) and do not react to changing circumstances, for example, to reduce the risk in their portfolio if the investments have exceeded expectations. As a result, our analysis of the likelihood of claimants receiving either over 120% compensation or under 90% compensation could be overestimates, especially for the longer term claimants who have more time to adjust their approach to changing economic conditions. The analysis is therefore helpful in comparing expectations of under- and over-compensation for claimants under different PIDRs, but limited weight should be placed on the precise percentages set out above. This limitation of the approach adopted is discussed further in Annex A in the Investment strategy section.

6. Sensitivities and other risks

Background

6.1 The analysis shown in the previous sections is based on a number of assumptions which have been agreed by the Panel. There are reasonable alternative views for these assumptions, and the sensitivity of the results of our analysis to these is considered in this section.

6.2 This section also explores risks that claimants may face in addition to those relating to the economic uncertainty discussed earlier.

Additional claimant types

6.3 As well as the three core claimant types described in Section 3, the Panel has asked GAD to consider a number of variations of these, reflecting what they believe to be plausible 'additional' claimant types.

6.4 As per the core types, the additional claimant types are expected to reflect realistic personal injury claimants with internally consistent characteristics. For example, a claimant with an investment term of 60 years would be more likely than a claimant with a 20 year term, to receive a relatively large lump sum.

6.5 Table 11 below sets out the combination of investment term, lump sum size, and investment strategy assumptions for each of the 'additional' 12 claimant types to be modelled. The three core claimant types are also shown in bold.

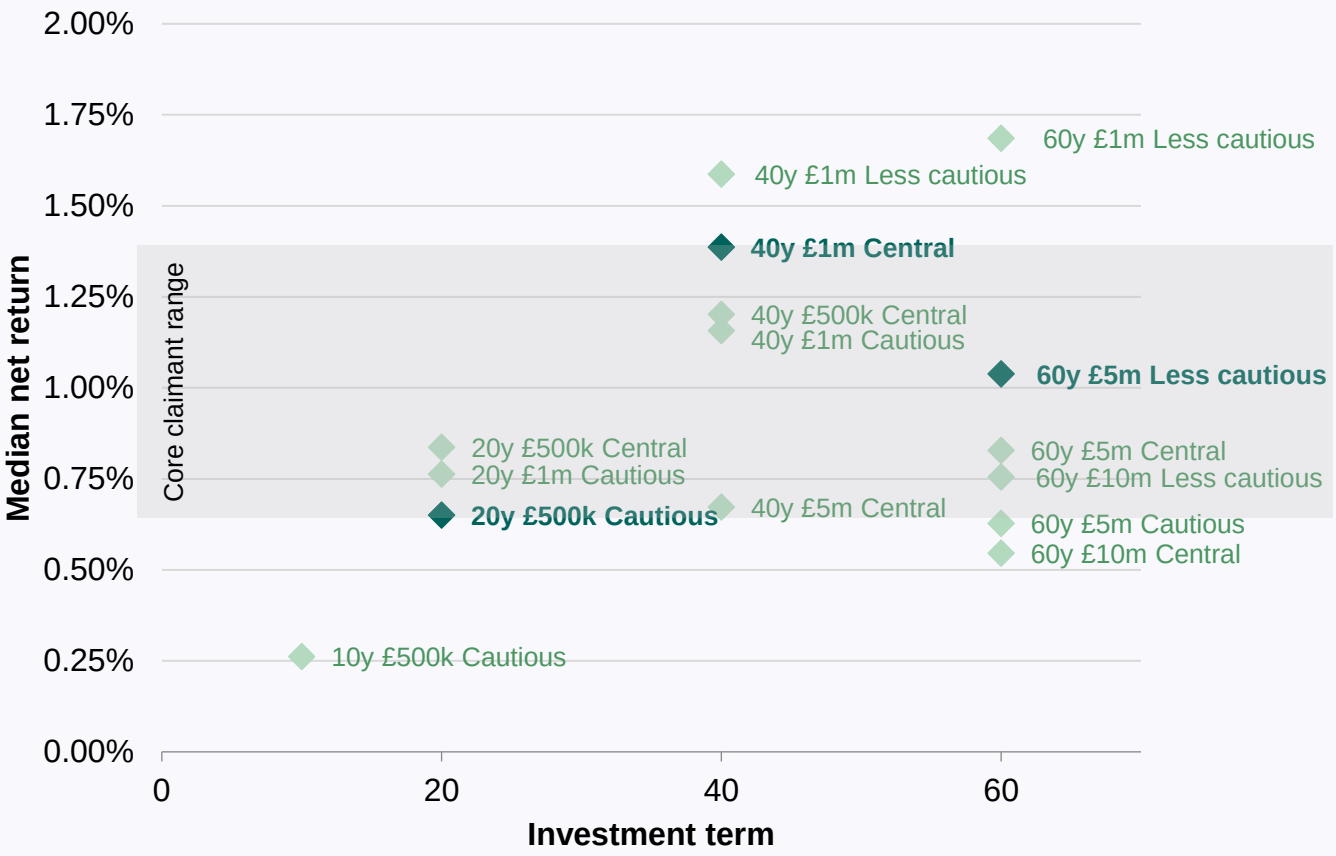
Table 11: Core and additional claimant types by investment term, lump sum size, and investment strategy

		Investment term			
		10 years	**20 years**	**40 years**	**60 years**
Lump sum size	**£500k**	Cautious	**Cautious (core)** Central	Central	
	£1m		Cautious	Cautious **Central (core)** Less cautious	Less cautious
	£5m			Central	Cautious Central **Less cautious (core)**
	£10m				Central Less cautious

6.6 Figure 7 shows the median net return for each of the 15 claimant types. The three core claimant types are highlighted in bold for comparison purposes and their range of returns are shaded in grey. A full breakdown of the components of the median net returns are shown in the summary in Annex A.

6.7 As discussed earlier, if the PIDR in force equals the claimant's median net investment return, then we assume they will receive 'sufficient compensation' (subject to all assumptions being borne out in practice). These returns should therefore be the starting point of the Panel's considerations in making recommendations for the PIDR.

Figure 7: Median net returns for core and additional claimant types



6.8 The median net return generally increases with investment term (when comparing risk-consistent invested portfolios and lump sum sizes). This is mainly because as investment term increases the cash reserve allocation decreases, resulting in a greater expected overall portfolio return.

6.9 Additionally, the median net returns for the majority of additional claimant types fall within the grey shaded area of 0.7% to 1.4%, i.e. the range covered by the three core claimant types.

6.10 One notable outlier is the 10-year claimant type whose median net return is much lower. This can be balanced against the high probability of the 10-year claimant having at least 90% compensation, which is above 75% for PIDRs up to 1.25%. Additionally, the impact of this disparity could potentially be addressed by using dual discount rates by term. This is discussed further in Section 7.

Sensitivity of results to model assumptions

6.11 The section above sets out the median net investment returns for the alternative claimant types, covering different assumed investment terms, lump sum sizes, and investment strategies. The below covers sensitivities to the other key assumptions made.

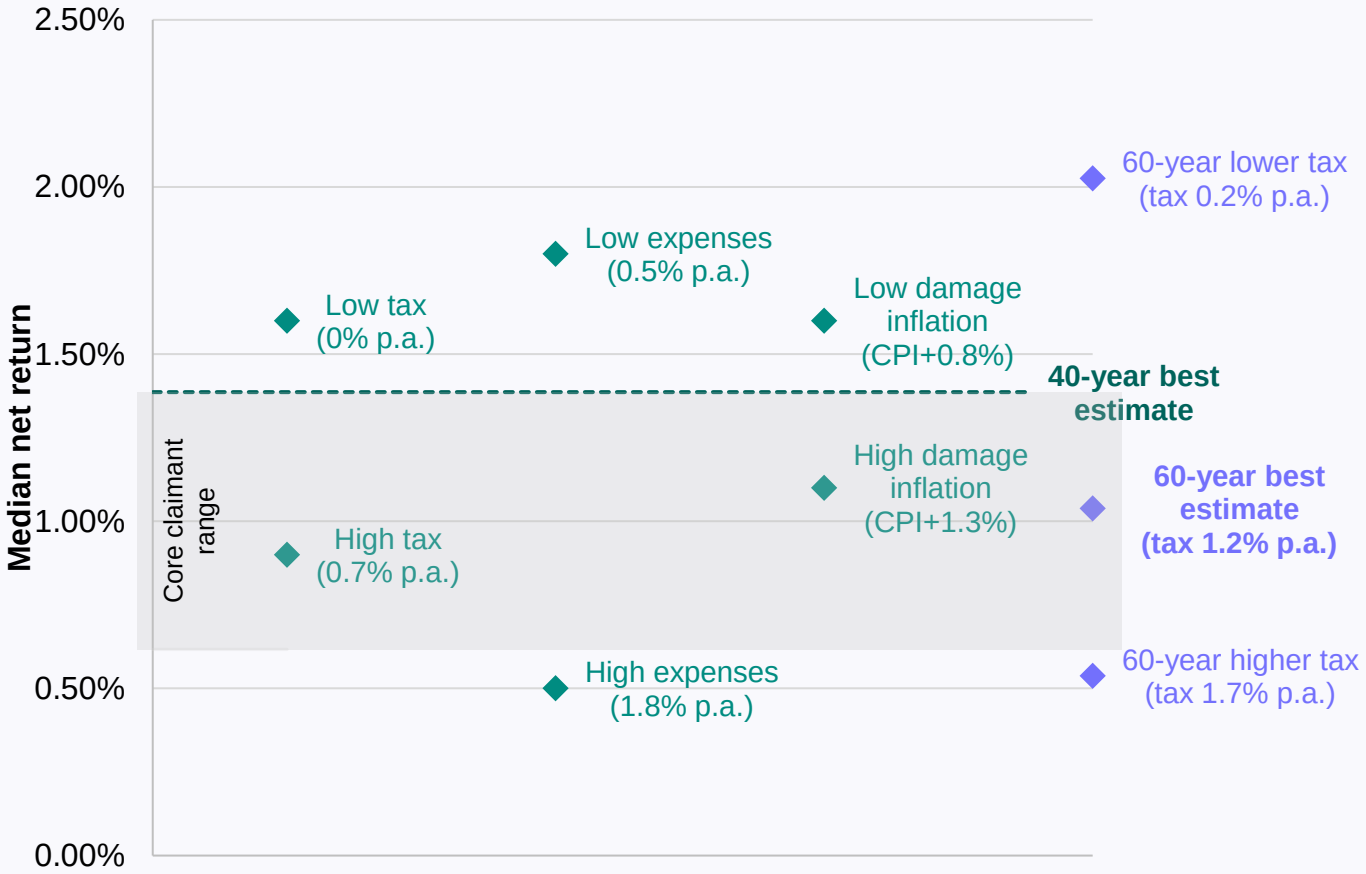
Expenses, tax, and damage inflation assumptions

6.12 The Panel wanted to consider the impact of alternative expenses, tax, and damage inflation assumptions on the median net returns of the 40-year claimant. The alternatives agreed with the Panel reflect the top and bottom of what we assess to be the 'reasonable ranges' for each assumption for the 40-year claimant, recognising it is possible that a claimant's expenses, tax, or level of damage inflation could be outside of these ranges.

6.13 Additionally, for the 60-year claimant, the Panel wishes to consider the impact of alternative tax drag assumptions on their median returns, given the uncertainty that exists around this assumption. In particular, there is evidence to suggest that tax management strategies exist to reduce the tax burden, but no robust evidence quantifying the effect.

6.14 The analysis shows that most of the sensitivities considered fall within or above the core claimant range. If a claimant is assumed to have significantly higher expenses or particularly high tax (through having a very large lump sum of £10m), then they would also have a median net return marginally below the core range. It is, however, expected that few claimants would have such high expenses without expecting some additional benefits not allowed for in this analysis (e.g. through active management of the portfolio) or would have such a high tax drag (as claimants with the largest lump sums could utilise more efficient tax management strategies than are allowed for in this analysis) and as such, even fewer claimants are expected to have combinations that would reduce their median net returns further (such as high tax and high expenses). The impact on median net returns is illustrated graphically in Figure 8 overleaf.

Figure 8: 40-year and 60-year core claimant types
Median net returns under alternative assumptions



6.15 The above assumptions have been modelled as deductions to the investment return that do not vary with each simulation of investment returns. This means that any increase or decrease in assumption will result in the median net investment return increasing or decreasing by the same amount.

6.16 The rationale for each of these alternative assumptions is explored in Annex C.

Investment returns

6.17 The Panel has asked GAD to model investment returns using economic simulations from two commercial providers as at 31 March 2024, with claimant's investment term assumed to begin in 2024. The Panel also requested sensitivity analysis to highlight the impact of them basing their view of investment returns on alternative justifiable assumptions.

6.18 The analysis below shows that economic conditions are expected to be broadly similar in the short and longer term and that different providers have broadly similar views. As such, basing the analysis on the average of the two providers' view of economic conditions as at 31 March 2024 is appropriate. It is however worth noting that, if economic conditions were to change significantly from assumed, then a new rate review might be appropriate.

6.19 We have tested whether the following alternative approaches would have a material impact on claimant outcomes:

- Economic simulations from either one of the two providers instead of both
- Economic simulations from both providers as at 30 September 2023
- Claimant's investment term begins in 2029 (i.e. just before the next standard five-yearly PIDR review cycle would likely conclude)

6.20 The median net returns would be expected to be at most 0.2% higher or lower if economic simulations from only one provider were used instead of two.

6.21 Median returns are also not very sensitive to the use of simulations calibrated to economic conditions at September 2023 or March 2024, changing by at most 0.1%. This is because economic conditions did not change significantly between these two dates. Economic conditions since March 2024 have been relatively stable, which suggests that analysis undertaken as at 31 March 2024 remains appropriate.

6.22 For claimants who begin their investment within the five-year period (e.g. up to 2029), median net returns would be expected to change by less than 0.1%. This is because investment returns are not expected to be materially different in the first five years after 2024 compared to returns in the medium and long term. As such, basing analysis on economic conditions from 31 March 2024 is appropriate for setting a PIDR over a five-year period.

Damages profile

6.23 In our modelling we assume a claimant's annual damage payments are level, before allowing for damage inflation, over their lifetime. In practice, however, they may have a different shape and could increase or decrease over time.

6.24 To test the potential impact of this, we have modelled two alternative scenarios: a doubling of short-term damages in the first 10 years only; and a doubling of long-term damages in the final 10 years of the term.

6.25 Our findings are that neither of the above scenarios have a significant impact on claimant outcomes, changing median net returns by less than 0.05%.

Further risks

6.26 The analysis set out in this report so far assumes that claimants' needs are defined at the outset of the award, that they do not change over time, and that the term of the award is fixed and corresponds to their assumed remaining lifespan.

6.27 In practice these needs may change after settlement, affecting the level and pace of withdrawals. This is known as 'needs risk' and to the extent their needs increase, they may not have an award that is sufficient to meet their needs, regardless of the investment return achieved. The Panel considers this to be out of scope for this review, as it is one of the factors that should be considered in the claims process, and therefore it is not considered further here.

6.28 If a claimant lives longer or shorter than the fixed term assumed in their settlement, they may exhaust their fund before they die, even if their investment returns and costs turn out

as assumed. This is known as ‘longevity risk’. The Panel considers this to be out of scope for this review but have commissioned analysis to highlight the impact of longevity risk on claimant outcomes.

Longevity risk

6.29 The Panel has asked GAD to carry out analysis on the potential impact of longevity risk by assuming each of the core claimant types lives for 5% shorter or longer than assumed.

6.30 Table 12 below shows the broad adjustment that would be required to the PIDR to counter the impact of living 5% longer than assumed.

Table 12: Longevity risk analysis

Core claimant type	Increased life expectancy	Change in PIDR
20-year	+1 year	-0.4%
40-year	+2 years	-0.2%
60-year	+3 years	-0.1%

6.31 This shows that longevity risk is greater for the 20-year claimant than the longer-term claimants and would be even greater for a 10-year claimant (broadly double the 20-year claimant impact). If any reduction were made to the PIDR to allow for this, it would likely disproportionately favour longer-term claimants. So even if longevity risk was within the scope of a PIDR review, adjusting the PIDR is unlikely to be the appropriate tool to mitigate the greater longevity risk faced by shorter term claimants, with the use of Periodical Payment Orders (PPOs) more likely to be appropriate.

7. Multiple discount rates

Background

7.1 In the previous sections we have assumed a single PIDR for all expected claimant terms and heads of loss. This results in disparities in modelled outcomes for different claimant types, particularly when considering claimants with shorter investment terms or a different profile for damages inflation than assumed.

7.2 The Panel has therefore asked GAD to carry out analysis to show how a system of multiple rates could be used to reduce these disparities.

7.3 Below, we consider two such options:

- A dual rate split by term of award, with the aim of addressing disparities for those claimants with a relatively short expected term.
- A dual rate split by heads of loss, with the aim of providing claimants with different levels of earnings-related damages to those assumed with a more appropriate level of compensation.

7.4 The analysis in this section shows that, if reducing the risk of under-compensation for claimants was the sole aim, then a dual rate both by term of award and by heads of loss would be preferable to a single rate. This analysis, however, does not take into account the actual claim process or the practical implementation considerations of moving away from a single rate.

Dual rates by term of award

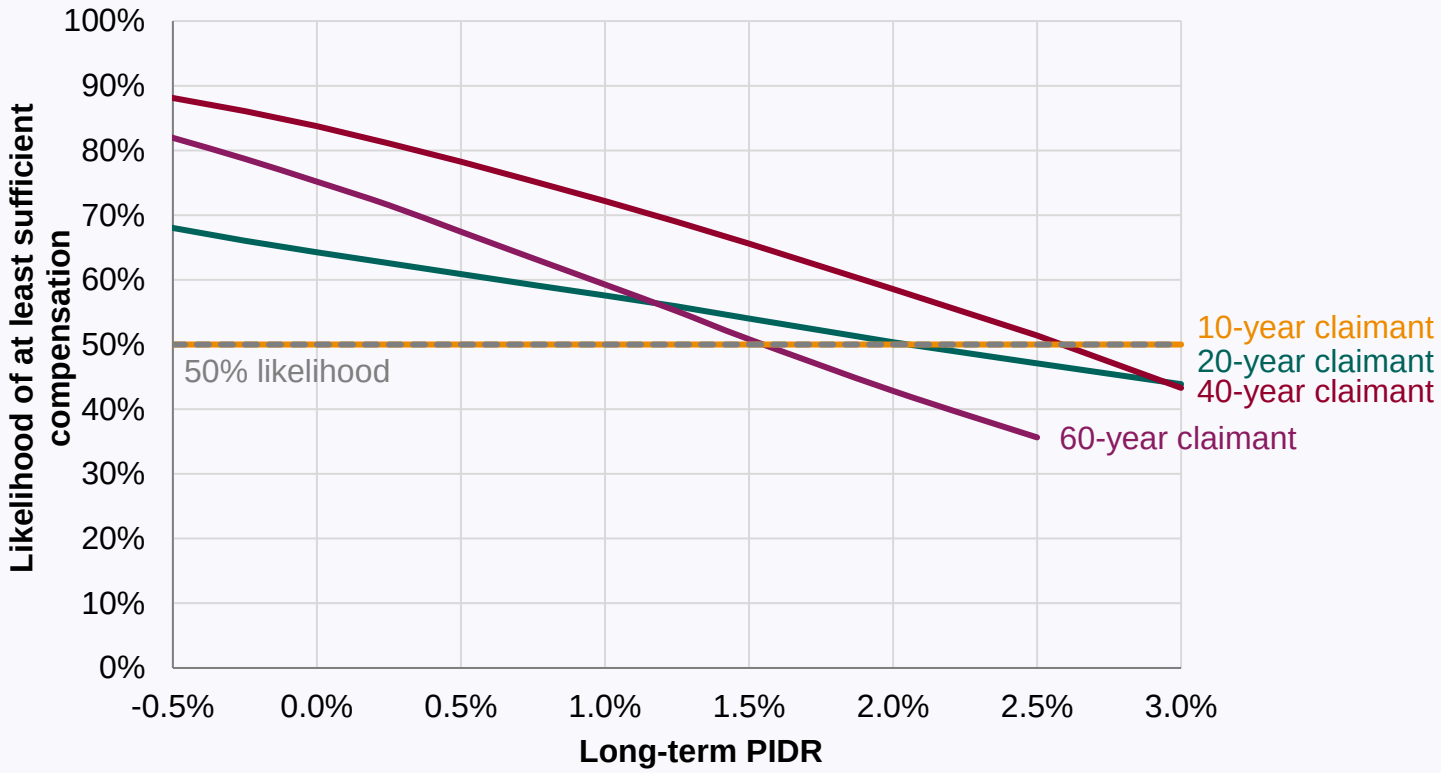
7.5 As shown in Section 6, the 10-year claimant type is expected to have a lower net investment return than the other claimant types considered, and so would be less likely to receive sufficient compensation under a single rate approach.

7.6 The Panel has asked GAD to model a dual rate PIDR approach assuming a short-term PIDR and a long-term PIDR with a ‘switching point’ of 10 years. Where the short-term PIDR is applied to all damage payments before the switching point and damage payments after this point are subject to the short-term PIDR for the first 10 years and the long-term PIDR thereafter (referred to as the ‘blended’ approach in the 2019 PIDR review). This approach avoids cliff edges, and the Panel have instructed GAD to illustrate the dual rate on this basis. Responses to the 2024 Call for Evidence suggested that if a dual rate by term approach were used, a suitable switching point would be between 10 and 15 years.

7.7 Our analysis illustrates how the likelihood of at least sufficient compensation changes under a short-term PIDR of 0.25% coupled with different long-term PIDRs. 0.25% has been selected as the short-term PIDR, as this is the median net investment return (rounded down to the nearest 0.25%) for the 10-year claimant type discussed in Section 6. In practice alternative approaches are feasible, but the Panel believe this approach is suitable for illustration.

7.8 The Figure 9 below shows the likelihood of at least sufficient compensation for the three core claimant types plus the additional 10-year claimant type under this dual rate system.

Figure 9: Likelihood of at least sufficient compensation under dual rates by term Short-term PIDR of 0.25%



7.9 Since the 10-year claimant type is subject only to the short-term PIDR (there are no damage payments beyond the switching point), their likelihood of at least sufficient compensation does not vary as the long-term PIDR changes. This likelihood is around 50% given that for this illustration, as the short-term PIDR has been set near to the median net investment return for this claimant type.

7.10 This figure shows that a combination of a short-term and long-term rate could be chosen such that the differences in the likelihood of at least sufficient compensation between the claimant types is less marked than under a single rate approach.

7.11 Table 13 compares the likelihoods of at least sufficient compensation for each of the four claimant types under both a dual rate and a single rate approach (the figures in **green** highlight those cases in which there is more than a 50% likelihood of claimants receiving at least sufficient compensation and those in **red** highlight cases in which there is less than a 50% likelihood). The single and dual PIDRs chosen for this comparison are those which give a similar likelihood (63% and 66%) of at least sufficient compensation under both approaches for the 40-year core claimant.

Table 13: Likelihood of at least sufficient compensation
Comparison of dual rate by term of award versus single rate approach

PIDR	Likelihood of at least sufficient compensation			
	Claimant type			
	10-year	20-year	40-year	60-year
Short: 0.25% Long: 1.50%	50%	54%	66%	51%
1.00%	28%	40%	63%	50%

7.12 It can be seen that the differences in likelihood of at least sufficient compensation between the claimant types is less marked under a dual rate as opposed to a single rate approach, and it is feasible to achieve a reasonable likelihood of at least sufficient compensation for shorter term claimants without significantly impacting the equivalent likelihoods for longer term claimants.

7.13 However, it is worth noting that the range of outcomes is smaller for the shorter term claimant. Focusing on the illustrative example given above, whilst they have a low probability of being at least sufficiently compensated under a single rate, their median compensation level is close to 100% (at 96% for the 10-year claimant and 97% for the 20-year claimant, as shown in Figure 22 in Annex D) and they have a high likelihood of achieving at least 90% sufficient compensation. This is shown in Table 14 below, for each of the four claimant types.

Table 14: Likelihood of at least 90% compensation

Comparison of dual rate by term of award versus single rate approach

PIDR	Likelihood of at least 90% compensation			
	Claimant type			
	10-year	20-year	40-year	60-year
Short: 0.25% Long: 1.50%	91%	83%	80%	64%
1.00%	82%	73%	78%	64%

7.14 There are various alternative approaches to setting a dual rate by term of award, none of which would be expected to significantly improve the balance of outcomes versus the dual rate approach tested.

Dual rates by heads of loss

7.15 The Panel has asked GAD to explore the potential impact on claimant outcomes of a system of dual rates split by heads of loss. This could provide those with different levels of earnings-related damages to those assumed, with a more appropriate level of compensation.

7.16 One approach would be to have different PIDRs applicable to each of earnings-related damages and prices-related damages. These PIDRs would be derived by adopting the same assumptions as under a single PIDR approach, with the exception of assumed damage inflation.

7.17 We therefore consider the impact of such an approach on the likelihood of the following two example claimant types achieving at least sufficient compensation:

- 40-year claimant but with 100% earnings-related damages
- 40-year claimant but with 50/50% earnings/price-related damages

7.18 Under a single rate approach, we assume claimants' damages are around 75% earning-related, i.e. around the middle of a range of 65% to 85%, as discussed in the 'Damage profile and inflation' section of Annex A.

7.19 In doing so, we use the following damage inflation assumptions:

- Earnings-related only: CPI+1.25% p.a. (in the reasonable range of assumed future earnings-related inflation, as discussed in Annex A)
- Price-related only: CPI+0% p.a.

7.20 For a claimant with 100% earnings-related damages, assumed annual damage inflation would be CPI+1.25% (0/100% weighted average of CPI+0% and CPI+1.25%), which is 0.25% higher than the CPI+1% assumption in our single rate analysis. Therefore, the impact of the dual-rate PIDR applicable to this claimant, would be equivalent to a PIDR 0.25% lower than under a single rate approach.

7.21 For a claimant with 50% earnings-related damages, assumed annual damage inflation would be around CPI+0.6% (50/50% weighted average of CPI+0% and CPI+1.25%), which is about 0.4% lower than the assumption in our single rate analysis. Therefore, the impact of the dual-rate PIDR would be equivalent to a PIDR 0.4% higher than under a single rate approach.

7.22 As a result, the 100% earnings-related claimant would receive a higher lump sum than under a single rate approach, while the 50% earnings-related claimant would receive a lower lump sum. In other words, under a single rate approach the 100% earnings-related claimant may be under-compensated (because their level of damage inflation may be higher than assumed), while the 50% earnings-related claimant may be over-compensated.

Annex A: Assumptions

A.1 Summary

A.1.1 The Panel has agreed to model three 'core' claimant types that, between them, are expected to reflect a large proportion of claimants within the claimant universe. To cover this wide range, it is reasonable to assume the 20-year claimant has the smallest lump sum in the range and the most cautious investment strategy, and the inverse for the 60-year claimant (the largest lump sum and the least cautious investment strategy). There is limited data on the exact nature of the claimant universe but as discussed in the 'Lump sum' section of this annex, Association of British Insurers (ABI) and NHS Resolution (NHS R) data suggests that the analysis does cover a large proportion of claimant outcomes.

A.1.2 The additional claimant types are also expected to reflect realistic personal injury claimants with internally consistent characteristics. For example, a claimant with a 60-year investment term is more likely to receive a larger lump sum than a 20-year claimant.

A.1.3 The Panel have agreed the investment term, lump sum size, investment strategy and other taxable income assumptions that define the range of core and additional claimant types, together with the resulting best estimate net investment returns and the additional assumptions contributing to these returns.

A description of each is set out below:

- **Investment term** – The length of time over which the claimant invests their lump sum to fund their damages. The lump sum is intended to be exhausted at the end of this term.
- **Lump sum size** – The amount awarded to the claimant for their future damages, excluding any Periodical Payment Orders and costs not subject to the PIDR (for example, accommodation costs). This is derived by discounting the future damages at the PIDR.
- **Investment strategy** – The asset allocations the claimants are assumed to invest in over their whole investment term, and is composed of the invested portfolio and the cash reserve.
- **Investment returns** – The annual income generated through investment of the lump sum in the overall investment portfolio. This is before any allowance for damage inflation, tax and expenses.
- **Expenses** – The annual cost of generating investment returns due to investment advice, fund management and platform fees.
- **Other taxable income** – The claimant's income in addition to the returns on the investment portfolio that may be subject to income tax, such as their salary or pension payments.
- **Tax** – The annual cost due to taxes arising from the investment of the lump sum.
- **Damage profile and inflation** – The total damages which need to be met depend on whether the level of annual damages are broadly flat, decreasing or increasing over time, and what inflationary pressures apply to those damages.
- **Net investment returns** – Investment returns net of expenses, tax and damage inflation.

A.1.4 Table 15 sets out the combination of assumptions for each modelled claimant type. The three core claimant types are highlighted in bold. The assumptions for term, lump sum size, investment strategy, other taxable income, and damage inflation were set directly by the Panel, while assumptions for cash reserve, investment returns, expenses, and tax have been calculated from assumptions set by the Panel.

Table 15: Core and additional claimant types assumptions

Claimant type	Term (years)	Lump sum size	Investment strategy	Cash reserve (% of portfolio)	Other taxable income p.a.
10-year	10	£500k	Cautious	50%	£30k
20-year	**20**	**£500k**	**Cautious**	**30%**	**£30k**
20-year: central	20	£500k	Central	30%	£30k
20-year: £1m	20	£1m	Cautious	30%	£7k
40-year	**40**	**£1m**	**Central**	**15%**	**£7k**
40-year: cautious	40	£1m	Cautious	15%	£7k
40-year: less cautious	40	£1m	Less cautious	15%	£7k
40-year: £500k	40	£500k	Central	15%	£30k
40-year: £5m	40	£5m	Central	15%	£7k
60-year	**60**	**£5m**	**Less cautious**	**10%**	**£7k**
60-year: central	60	£5m	Central	10%	£7k
60-year: cautious	60	£5m	Cautious	10%	£7k
60-year: £1m	60	£1m	Less cautious	10%	£7k
60-year: £10m	60	£10m	Less cautious	10%	£7k
60-year: central £10m	60	£10m	Central	10%	£7k

Claimant type	Investment returns p.a.	Expenses p.a.	Tax p.a.	Damage inflation p.a.
10-year	CPI+2.3%	0.7%	0.4%	CPI+1.0%
20-year	**CPI+2.9%**	**0.9%**	**0.3%**	**CPI+1.0%**
20-year: central	CPI+3.1%	0.9%	0.3%	CPI+1.0%
20-year: £1m	CPI+2.9%	0.8%	0.3%	CPI+1.0%
40-year	**CPI+3.5%**	**0.9%**	**0.2%**	**CPI+1.0%**
40-year: cautious	CPI+3.3%	0.9%	0.2%	CPI+1.0%
40-year: less cautious	CPI+3.7%	0.9%	0.2%	CPI+1.0%
40-year: £500k	CPI+3.5%	1.1%	0.2%	CPI+1.0%
40-year: £5m	CPI+3.5%	0.6%	1.3%	CPI+1.0%
60-year	**CPI+3.8%**	**0.6%**	**1.2%**	**CPI+1.0%**
60-year: central	CPI+3.6%	0.6%	1.2%	CPI+1.0%
60-year: cautious	CPI+3.4%	0.6%	1.2%	CPI+1.0%
60-year: £1m	CPI+3.8%	1.0%	0.2%	CPI+1.0%
60-year: £10m	CPI+3.8%	0.6%	1.5%	CPI+1.0%
60-year: central £10m	CPI+3.6%	0.6%	1.5%	CPI+1.0%

Investment strategy assumptions

A.1.5 Table 16 sets out the asset allocations for all claimant types with the three core (red column headings) and the additional claimant types (green column headings). The three types of invested portfolio considered (cautious, central, less cautious) are assumed not to vary by investment term. However, the cash reserve allocation does vary by term and this results in an overall portfolio allocation which also varies over term.

Table 16: Overall asset allocations

Asset class	Investment strategy / term								
	Cautious				Central			Less cautious	
	10 years	20 years	40 years	60 years	20 years	40 years	60 years	40 years	60 years
Lower risk / cash	**80.0%**	**72.0%**	**66.0%**	**64.0%**	**65.0%**	**57.5%**	**55.0%**	**49.0%**	**46.0%**
Cash reserve	**50.0%**	**30.0%**	**15.0%**	**10.0%**	**30.0%**	**15.0%**	**10.0%**	**15.0%**	**10.0%**
Lower risk	**30.0%**	**42.0%**	**51.0%**	**54.0%**	**35.0%**	**42.5%**	**45.0%**	**34.0%**	**36.0%**
Cash	1.3%	1.8%	2.1%	2.3%	1.8%	2.1%	2.3%	2.1%	2.3%
Gilts	8.6%	12.1%	14.7%	15.5%	10.0%	12.1%	12.8%	9.6%	10.1%
Index-linked gilts	8.6%	12.1%	14.7%	15.5%	10.0%	12.1%	12.8%	9.6%	10.1%
Corporate bonds	11.5%	16.1%	19.6%	20.7%	13.3%	16.2%	17.1%	12.8%	13.5%
Higher risk	**20.0%**	**28.0%**	**34.0%**	**36.0%**	**35.0%**	**42.5%**	**45.0%**	**51.0%**	**54.0%**
UK equity	8.0%	11.2%	13.6%	14.4%	14.0%	17.0%	18.0%	20.4%	21.6%
Overseas equity	8.0%	11.2%	13.6%	14.4%	14.0%	17.0%	18.0%	20.4%	21.6%
Diversifiers	4.0%	5.6%	6.8%	7.2%	7.0%	8.5%	9.0%	10.2%	10.8%

A.1.6 The remainder of this section describes how each of these assumptions were decided upon by the Panel.

A.2 Investment term

A.2.1 The assumption regarding the term over which claimants invest is key to modelling their outcomes. This is because it impacts on investment return expectations, which vary over time, and also on the choice of investment strategy, with longer terms potentially allowing for greater risk to be taken. The investment term assumption also impacts on the assumed investment expenses and tax costs.

A.2.2 The Panel wanted to undertake analysis on a range of investment terms that were expected to cover a significant majority of claimants. As set out in this sub-section, the evidence provided suggested that terms of 20 to 60 years would provide an appropriate range consistent with that aim.

As a result, the Panel has asked GAD to undertake analysis on core claimant types with assumed investment terms of 20, 40, and 60 years.

A.2.3 Whilst the Panel expected claimants with terms under 20 years to represent a small proportion of the claimant universe, they are mindful that their expected outcomes should also be considered, as they may differ from those in the core range.

In order to more fully understand the outcomes of claimants with short investment terms, the Panel has asked GAD to undertake analysis for an additional claimant type with an assumed investment term of 10 years.

A.2.4 The Panel also expected claimants with a life expectancy over 60 years to have similar investment outcomes to a claimant with a 60 year investment term and so it is appropriate not to model these claimants separately.

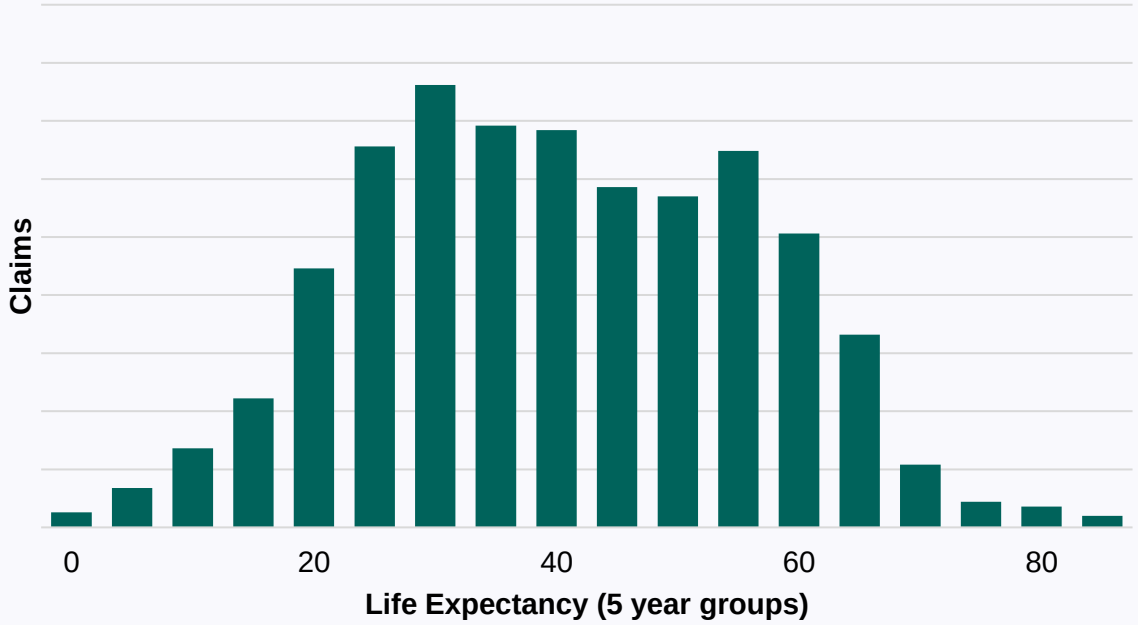
A.2.5 The information gathered in the responses to the 2024 Call for Evidence forms the basis for the assumption for investment term. We have considered a number of possible options for this assumption in order to encompass a wide range of claimants.

A.2.6 In analysing the data provided, we assume claimants will invest their lump sum to meet their needs over their remaining lifetime. The investment term therefore corresponds to the claimant's life expectancy at settlement.

A.2.7 One of the most extensive sources of information on claimant investment term is included in the ABI's 2024 Call for Evidence response. An extract from the data they provided is reproduced below, showing estimated life expectancies in respect of a representative sample of motor, public and employer liability claims from the last five years with award sizes greater than £250k.

A.2.8 Our understanding is that the data the ABI holds are the claimants' ages at settlement and that these life expectancies have been derived to be consistent with the current Ogden tables[6] (which assumes that a claimant's life expectancy is the same as the general UK population). Evidence from other responses suggested that only a very small proportion of claimants are assumed to have a lower life expectancy than the general population (excluding NHS R claims).

Figure 10: Claimant life expectancy distribution from the ABI's response to the 2024 Call for Evidence



A.2.9 It can be seen that the significant majority of these claimants have investment terms of between around 20 and 60 years, with the median being around 40 years.

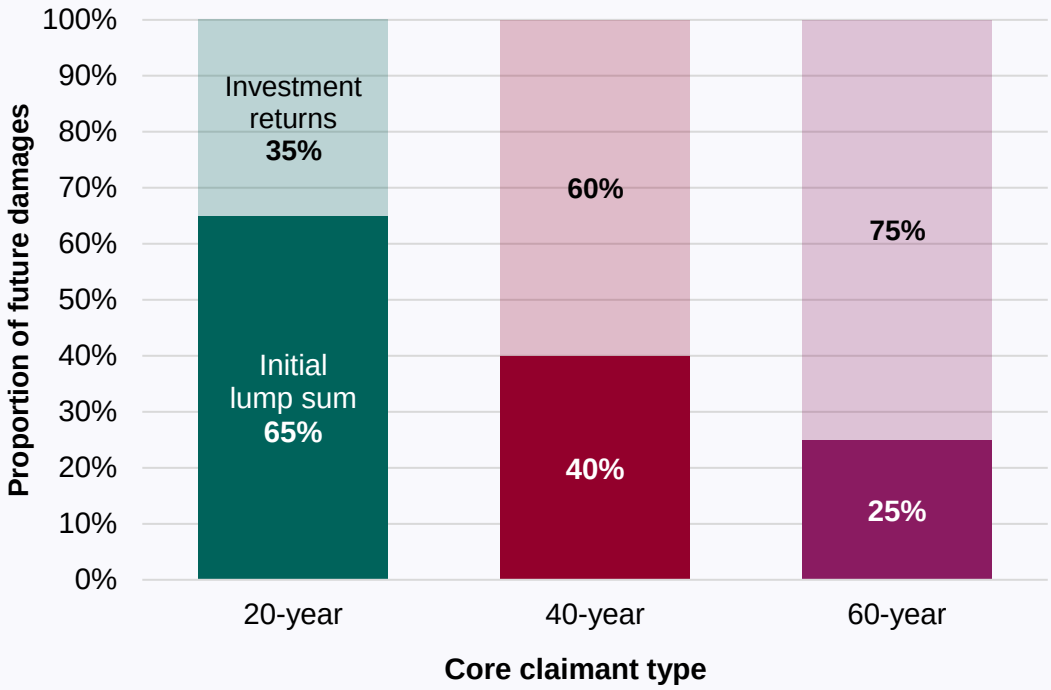
A.2.10 Evidence from NHS R (relating to clinical negligence claims) and claimant lawyer respondents suggested a lower average life expectancy that was closer to 35 years. However, we note that an average life expectancy will vary across different claim groupings and will depend on the approach adopted to derive these averages. This may reflect a greater proportion of claimants with more serious injuries than average, or may reflect a higher claimant age profile. This average is captured within the range of investment terms chosen.

[6] https://www.gov.uk/government/publications/ogden-tables-actuarial-compensation-tables-for-injury-and-death

Materiality of term on PIDR

A.2.11 Claimants with shorter investment terms are less impacted by the PIDR as a percentage of their lump sum. To illustrate the impact of this shorter time horizon, Figure 11 below illustrates the proportion of lump sum to investment returns expected to meet the damages (for simplicity this is shown on an illustrative PIDR of around 1% and considers amounts in nominal terms, allowing for damage inflation of around 3% p.a.).

Figure 11: Approximate proportion of damages met through initial lump sum and through investment returns



A.2.12 The lump sum awarded to the 20-year claimant would be approximately 65% of their total expected future damage payments. To achieve sufficient compensation, the remaining 35% of future damages would need to be generated through investment returns.

A.2.13 In contrast, the lump sum awarded to the 60-year claimant would only be around 25% of total future damage payments. Around 75% of their future damages would need to be generated through investment returns.

A.2.14 The proportion of total future needs that are met through investment returns (rather than the lump sum itself) is much lower for the 20-year claimant than for the longer-term claimants. Consequently, the expected spread of compensation levels resulting from the spread of investment outcomes is lower for the 20-year claimant.

A.3 Lump sum size

A.3.1 The assumed lump sum size impacts on the assumed investment expenses and tax, but the investment return and damage inflation are not assumed to be impacted by lump sum size.

A.3.2 The Panel wanted to undertake analysis on a range of lump sum sizes that were expected to cover a significant majority of claimants. As set out in this sub-section, the evidence provided suggested that lump sums up to £5m, would provide an appropriate range consistent with that aim.

A.3.3 The Panel noted that, while a majority of lump sums would be less than £500k, the larger claims are those that are most significantly impacted by the PIDR and represent a large proportion of the total value of claims.

As a result, the Panel has asked GAD to undertake analysis on core claimant types with assumed lump sum sizes of £500k, £1m, and £5m.

A.3.4 Whilst the Panel expected claimants with lump sums over £5m to represent a small proportion of the claimant universe, they are mindful that their expected outcomes should also be considered, as they may differ from those in the core range.

To more fully understand the outcomes of claimants with large lump sums, the Panel has asked GAD to undertake analysis on an additional claimant type with a £10m lump sum.

A.3.5 The data gathered in the responses to the 2024 Call for Evidence forms the basis for the lump sum size assumption.

A.3.6 It is important that this data only reflects those awards (or portions of awards) that are subject to the PIDR, and excludes aspects such as accommodation costs. As such, in some cases it has been necessary to make an approximate adjustment to the data to allow for this.

A.3.7 One of the most extensive sources of information on lump sum sizes is included in the ABI's response to the 2024 Call for Evidence, as mentioned in the 'Investment term' sub-section above. ABI's data showed the distribution of total damage award sizes with award sizes greater than £250k. The data also included the proportion of awards subject to the PIDR.

A.3.8 We have used this data to estimate the average total damage award size and the average award amount subject to PIDR (known in this report as the 'lump sum') within each total damage award cost bracket. We have also estimated the proportion of claims within each bracket by amount. This is summarised in Table 17.

Table 17: Distribution of award sizes from ABI data and implications for lump sum sizes

Total damage award cost bracket	Proportion of claims by number	Average total damage award	Proportion of total award subject to PIDR	Estimated average lump sum sizes	Estimated proportion of total lump sums in award bracket
£250k - £500k	47%	£0.3m	32%	£0.1m	8%
£500k - £1m	26%	£0.7m	46%	£0.3m	13%
£1m - £3m	19%	£1.7m	62%	£1.1m	30%
£3m - £5m	4%	£3.8m	70%	£2.7m	17%
Over £5m	3%	£8.3m	79%	£6.6m	33%
Overall				**£0.7m**	

A.3.9 The data suggests that lump sums are skewed towards the smaller sizes. Nearly half of total awards were between £250k and £500k with an estimated average lump sum size of around £100k. As a proportion of total lump sum amounts, these claims only form around 8%. Given that these lump sums are relatively small individually (and so are less sensitive to the PIDR in monetary terms), have a lower proportion of total award subject to PIDR and represent a small proportion of total lump sums across all claims, it would be appropriate to focus analysis on larger lump sums than this.

A.3.10 The average lump sum amount, across the sample, is estimated to be around £0.7m. However, lump sum sizes span a wide range and can go many multiples higher than the average. As such, it would be more appropriate to model a range of lump sum sizes to reflect this, rather than focus on the average.

A.3.11 A large proportion of claims, by both number and amounts subject to PIDR, have total awards between £500k and £3m, shown in the second and last columns of Table 17. We estimate the average lump sum for each bracket to be £0.3m and £1.1m. Therefore, modelling separate lump sum sizes of £0.5m and £1m would both capture a large proportion of lump sums in practice and demonstrate the sensitivity of outcomes to this assumption.

A.3.12 At the higher end, while the proportion of total awards over £5m is only 3% by number, it forms a much larger proportion of total lump sums – around 33%. Therefore, it would be appropriate to consider claimants with lump sum sizes of this magnitude.

A.3.13 Along with lump sums of £500k and £1m, a lump sum size of £5m would be appropriate to adequately reflect the range of lump sums given in the ABI data.

A.3.14 For awards over £5m, an estimated average lump sum of £7m means there will be a reasonable proportion of lump sums higher than £7m, suggesting that lump sums up to £10m are plausible. This is supported by other data sources. The Forum of Complex Injury Solicitors (FOCIS) data submitted to the 2024 Call for Evidence showed claims above £10m in the financial year 2022/23. NHS R's supplementary annual statistics[7] also quote an average total claim size for the £4.25m+ bracket since 2019/20 of around £12.5m.

[7] https://resolution.nhs.uk/wp-content/uploads/2023/10/Supplementary-Annual-Statistics-2022-23-3.xlsx

While both of these include costs not subject to the PIDR (such as PPOs in the case of NHS R), it is plausible that within the data some lump sums have reached £10m.

A.3.15 Another consideration is that the size of the lump sums within the data provided are influenced by the PIDR at the time of those awards being made. If the PIDR were to be changed, then future lump sum sizes would be calculated under the new PIDR, and the distribution might be different to that seen over the last five years.

A.3.16 A PIDR of -0.25% applies to all claims in the ABI and NHS R data. If the PIDR were to be increased by one percentage point (to 0.75%), lump sum sizes on average would decrease by around 20%, assuming investment terms of around 40 years on average. A further one percentage point increase (to 1.75%) would decrease lump sum sizes by around 30% versus under the current PIDR.

A.3.17 However, given that we are modelling a range of lump sum sizes spanning multiple orders of magnitude, making a percentage adjustment to these sizes to allow for a different PIDR would not result in materially different outcomes across all claimant types. Therefore, we have not made an explicit allowance for a change in PIDR.

A.3.18 We have also not adjusted lump sizes for any other factors, such as the take-up of PPOs. Some responses to the 2024 Call for Evidence stated that the level of the PIDR could influence claimant choices to accept a PPO and impact the size of the resulting lump sum subject to the PIDR. This evidence was anecdotal in nature and we do not expect it to have a material impact on lump sum sizes.

A.4 Distribution of claimants by term and lump sum size

A.4.1 As well as defining the core claimants, the Panel have asked GAD to investigate the 2024 Call for Evidence data to draw out insights of how claimants are distributed when considering the interactions between lump sum size and term. The two most comprehensive data sets of both term and lump sum were provided by the ABI and NHS R as discussed above. It is our understanding that a significant majority of claimants would be represented in one of those two data sets. The data provided are not sufficiently granular or directly comparable to draw clear conclusions as to the relative level of claims or number of claimants represented by each, but they suggest that they are within the same order of magnitude. It is therefore appropriate to consider both ABI and NHS R data when drawing conclusion on the distribution of claimants by term and lump sum size.

A.4.2 Drawing conclusions from the ABI and NHS R data is difficult but in broad terms it shows that:

- A majority of claimants have an expected term of 30 years or longer.
- The ABI data suggests around a quarter of claimants (slightly less when weighted by claim amounts) have an expected term of less than 30 years.
- Both data sets have a significantly large proportion of claims for lower PIDR amounts, under the £500k lower bound assumed in the analysis. However, assuming a lump sum of £250k instead of £500k would not materially impact on the analysis (with lower tax impacts broadly netting off higher expected expenses).
- There is a small proportion of claimants with expected term less than 30 years who have a lump sum significantly larger than £1m, which is not covered in the claimant analysis.

ABI data

A.4.3 The ABI data provided, enables us to estimate investment terms broken down by lump sum sizes. Considering the proportions by number of personal injury claimants and by amounts subject to PIDR are set out in Tables 18 and 19.

Table 18: Lump sum and term breakdowns by number of personal injury claimants

	Expected term groupings / years			
Average lump sum sizes	**0-30**	**30-50**	**50+**	**Total**
£0.2m	19%	31%	23%	**74%**
£1.1m	4%	8%	7%	**19%**
£2.7m	1%	2%	2%	**4%**
£6.6m	0%	1%	3%	**3%**
Total	**24%**	**41%**	**35%**	

Table 19: Lump sum and term breakdowns by amounts subject to PIDR

	Expected term groupings / years			
Average lump sum sizes	**0-30**	**30-50**	**50+**	**Total**
£0.2m	5%	9%	7%	**21%**
£1.1m	6%	12%	12%	**30%**
£2.7m	3%	6%	8%	**17%**
£6.6m	2%	6%	26%	**33%**
Total	**16%**	**32%**	**52%**	

NHS R data

A.4.4 Estimating the same breakdown is not possible with the NHS R data provided or publicly available, however we can use it to estimate an average implied term for different lump sum sizes along with the relevant number of claimants. The same approach, to determine the lump sum (the average award subject to PIDR) from the total award cost bracket, has been adopted as for the ABI (as set out in the sub-section above) and is set out in Table 20.

A.4.5 The data provided suggests that the vast majority of awards are below £1m, for which the amounts subject to PIDR are generally below £250k. Table 20 shows awards over £1m only, for which we understand the sample data provided is representative of claims in recent years. While awards above £1m form a low proportion of total awards by number, they form a more sizeable proportion of the total amounts awarded, and therefore reflect a material proportion of lump sums subject to PIDR.

A.4.6 However, we caveat that while the sample for each award cost bracket may be representative of all recent claims of these sizes, the overall sample size, across all award cost brackets, is still relatively small and not necessarily representative of the total book of claims, which limits the conclusions that can be drawn about the potential distribution of future claims. The data also includes awards with a PPO component, and the total award cost includes the capitalised value of future PPO payments (which is partly why the average lump sum sizes are significantly below the total award costs).

Table 20: Lump sum breakdowns by amounts subject to PIDR

Total award cost bracket	Average lump sum sizes	Average implied term	Proportion above £1m by number of claimants
£1m - £2m	**£0.4m**	34	23%
£2m - £4.25m	**£0.8m**	31	21%
£4.25m - £13.5m	**£2.3m**	36	33%
£13.5m+	**£4.9m**	54	23%

A.5 Investment strategy

Approach

A.5.1 Claimants invest their lump sums in a portfolio of assets in order to meet their future needs. The combination of assets they invest in, and in what proportions, is referred to as their 'investment strategy'.

A.5.2 Investment strategy determines the level and volatility of returns claimants achieve, and impacts on the investment expenses and tax costs they are subject to. These in turn impact on the likelihood of claimants' needs being met over their lifetime.

A.5.3 The assumed investment strategy is subject to the legislative requirements[8]. In particular, the claimant is assumed to:

- be 'properly advised on the investment of the relevant damages';
- hold 'a diversified portfolio of investments'; and
- take 'an approach that involves more risk than a very low level of risk, but less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims'.

A.5.4 The assumed portfolio must also 'have regard to the actual investments made by investors of relevant damages'.

A.5.5 The Panel wanted to consider a range of appropriate investment strategies in line with the requirements of the Act and the data gathered in the responses to the 2024 Call for Evidence, coupled with that gathered from additional stakeholder engagement exercises.

As a result, the Panel has asked GAD to construct portfolios that consists of a cash reserve and an invested portfolio, and which represents an average portfolio held over the whole term.

Cash reserve

A.5.6 The Panel considered it appropriate to allow for the evidence that claimants held a cash reserve, in setting the portfolio. They noted a range of views on the suitable level and agreed that a cash reserve equating to the next three years of expected damage payments, was a reasonable assumption to make reflecting the average held in this manner over the investment term.

As a result, the Panel has asked GAD to include a cash reserve equating to an average of three years damage payments.

A.5.7 A theme which emerged from the 2024 Call for Evidence was that claimants are advised to hold a 'cash reserve' in addition to their 'invested portfolio' throughout their investment term, in order to meet expected damages in the next few years, to provide a buffer against needing to sell assets at inopportune times.

[8] https://www.legislation.gov.uk/ukpga/2018/29/part/2/enacted

A.5.8 In the remainder of this section we refer to the 'overall portfolio' as the combined 'cash reserve' and 'invested portfolio', where the invested portfolio reflects other assets held in respect of the award and can include a further allocation to cash.

A.5.9 Some respondents, particularly financial advisors, were of the opinion that the cash reserve equated to five years' worth of expected damage payments, whereas others, particularly insurers, were of the view that it equated to around two years' worth.

A.5.10 In addition to the above, in forming a view on what an appropriate assumption would be, for the proportion of assets held in the 'cash reserve', the Panel considered the following factors:

- **Actual investments**
  - Whilst evidence was provided around the fact that claimants were *advised* to invest in a 'cash reserve', there was a lack of evidence around whether they *actually* do this in practice.
  - Some respondents did include examples of large cash allocations in the first few years after claimants received their lump sum award. However, these were not necessarily representative of all claimants, and did not necessarily represent behaviour throughout their investment term.
  - Furthermore, it was unclear whether they included damages awarded that are not subject to the PIDR and therefore should not be taken into account.
- **Risk level**
  - The holding of a 'cash reserve' could potentially be viewed as an inefficient investment, resulting in an unnecessary reduction in investment returns without an adequate reduction in risk.
  - In particular, other asset classes such as short-dated gilts exist and could achieve similar aims to those intended by 'cash reserve' whilst providing higher expected investment returns.

A.5.11 It could also be argued that claimants with a PPO may have less need for a large cash reserve. However, outside of NHS R claims, take-up of PPOs is low and therefore it would not seem appropriate to allow for PPOs in making this assumption.

A.5.12 Some respondents also claimed that it can take at least two years for claimants to fully invest their lump sum award. This has been taken into consideration when setting the cash reserve and invested portfolio allocation assumptions, however it is of limited impact due to its short-term nature.

A.5.13 Assuming a cash reserve equating to three years of damages payments throughout the investment term means that as a proportion of the overall portfolio, it would increase over time.

A.5.14 However, in order to model the effect of the cash reserve, and for consistency of approach with the 'static' investment portfolio mentioned earlier, we have translated this 'three years of expected damage payments' into a static percentage of cash within the overall portfolio. This percentage is set out in Table 21 below for claimants with different assumed investment terms.

Table 21: Assumed average portfolio allocation to 'cash reserve' by investment term

Investment term	Cash reserve assumption % of overall portfolio
10 years	50%
20 years	30%
40 years	15%
60 years	10%

A.5.15 Taking the 10-year term claimant as an example, three years' worth of cash reserve will represent around 30% of the overall portfolio at the start of the term. However, as the claimant progresses through their term and the number of remaining years decreases, this percentage will increase to 100% by year 7. On average over the whole term, the cash reserve will represent approximately 50% of the overall portfolio.

A.5.16 The longer investment term, the lower the assumed percentage of the overall portfolio in respect of the cash reserve. This is because three years of damage payments represents a smaller proportion of a portfolio held on average.

Invested portfolio – asset allocation

A.5.17 Table 22 summarises the three invested portfolio allocations (excluding the cash reserve) to be modelled, following the approach agreed by the Panel, as set out in the sub-sections below.

Table 22: Invested portfolio allocations

	Investment strategy		
Asset class	**Cautious**	**Central**	**Less cautious**
Lower risk	**60.0%**	**50.0%**	**40.0%**
Cash	2.5%	2.5%	2.5%
Gilts	17.25%	14.25%	11.25%
Index-linked gilts	17.25%	14.25%	11.25%
Corporate bonds	23.0%	19.0%	15.0%
Higher risk	**40.0%**	**50.0%**	**60.0%**
UK equity	16.0%	20.0%	24.0%
Overseas equity	16.0%	20.0%	24.0%
Alternatives	8.0%	10.0%	12.0%

Invested portfolio - lower versus higher risk portfolio split

A.5.18 The Panel recognised that the appropriate level of investment risk that claimants can take is subjective and could vary by investment term. The Panel agreed that 40% to 60% would be a reasonable range for allocations to higher risk assets in the invested portfolio.

As a result, the Panel has asked GAD to construct invested portfolios with different allocations to the higher risk portfolio as follows: cautious (40%), central (50%), and less cautious (60%).

A.5.19 We consider a claimant's invested portfolio, excluding the cash reserve, to consist of a 'lower risk' portfolio and a 'higher risk' portfolio. The lower risk portfolio would consist of assets that aim to provide income to match a claimant's damages and are expected to have a lower volatility of returns, such as government bonds. The higher risk portfolio would consist of assets with higher expected volatility of returns but usually with higher expected returns in the long term, such as equities.

A.5.20 In general, claimants with a longer investment term can have a higher risk appetite since, on average, their fund is invested for longer and so they can withstand higher volatility in search of higher expected returns.

A.5.21 Responses to the 2024 Call for Evidence showed allocations to higher risk asset portfolios of around 40% to 60%, with an average of around 50%.

Invested portfolio – lower risk assets

A.5.22 The Panel's view is that assets in the lower risk portion of an invested portfolio typically consist of cash, corporate and government bonds (gilts), with the latter consisting of a mix of nominal and index-linked gilts. The Panel considered the evidence provided alongside their own experience of suitable investments to agree an appropriate split between those asset classes.

The Panel asked GAD to assume claimants hold a 2.5% allocation to cash, with the rest of the lower risk portion of the invested portfolio to be in bonds, split as follows: 30% nominal gilts, 30% index-linked gilts, and 40% corporate bonds.

A.5.23 For the allocation to gilts and corporate bonds, responses to the 2024 Call for Evidence were mixed on whether gilts or corporate bonds would be more favourable, with allocations to gilts suggested to be between 30-65%. Views were also broadly consistent with the evidence collected for the 2019 review, which concluded that a 60% gilts to 40% corporate bonds was appropriate.

A.5.24 In addition, there was a suggestion from one respondent that corporate bonds are currently becoming more popular due to volatility in gilt prices. However, we note this could be a short-term tactical change not representative of long-term investment strategies. Additionally, as claimants are expected to be buy-and-hold investors, gilt volatility may not be a significant concern for them.

A.5.25 Very few respondents provided information on the split between nominal gilts and index-linked gilts. Where information was provided, the split varied significantly, although the average was around an even split between the two.

A.5.26 For the cash allocation, the Panel considered a number of factors. These included the responses to the 2024 Call for Evidence which showed cash allocations in the invested portfolio (excluding the cash reserve) ranging from 2% to 18%, with an average of around 7%.

A.5.27 However, a lack of granularity exists around the interaction between this invested portfolio cash allocation and the cash reserve allocation. In particular, whether a lower allocation to the former is correlated to a higher allocation to the latter, and vice versa.

A.5.28 The Panel has therefore considered this evidence alongside their expectations of the level of cash required in a portfolio, when the claimant also holds a significant cash reserve. Normally, this cash would only be used for liquidity purposes from a trading perspective. As a result, a proportion between 0 and 5% would be a reasonable assumption to make, with 2.5% representing a reasonable mid-point.

Invested portfolio – higher risk assets

A.5.29 The Panel's view is that assets in the higher risk portion of an invested portfolio typically consist of equities alongside a wide range of alternative assets, with the former consisting of a mix of UK and overseas equities. The Panel considered the evidence provided, alongside their own experience of suitable investments, to agree an appropriate split between those asset classes and on how alternative assets should be allowed for.

A.5.30 The Panel agreed to assume an allocation to higher risk assets split 80% equities and 20% alternatives. The allocation to equities is assumed to be equally split between UK and overseas equities.

A.5.31 The Panel asked GAD to assume that the alternative asset allocation would consist of assets being used as diversifiers from equities as opposed to seeking returns in excess of them. This is intended to reduce the portfolio downside risk.

A.5.32 Responses to the 2024 Call for Evidence indicated that higher risk portfolios consist of equities, with many, including claimant representatives, suggesting that 'alternative' investments are also used. The latter argue that 'alternatives' are typically used as diversifiers to reduce downside risk, as opposed to seeking returns in excess of equities. A section of respondents argued that some, or even all, alternative asset classes are too risky for claimants to invest in. Overall, the average allocation implied by respondents was 80% equities and 20% 'alternatives'.

A.5.33 Responses indicated that the equity allocation itself is split between UK and overseas, with limited evidence of emerging market equity investment. There was a wide degree of variation between the percentage allocations provided, however the average was approximately 50% UK and 50% overseas equities.

A.5.34 Information pertaining to the different assets making up the 'alternatives' were not consistently provided as part of the 2024 Call for Evidence responses, and where they were, the responses were varied. However, those mentioned were typically property, private equity, hedge funds, infrastructure and commodities. In the absence of consistent information, a pragmatic approach to the makeup and modelling of the 'alternatives' portfolio has been taken. This reflects the fact that adding a large degree of additional complexity in this area does not necessarily result in an equivalent additional degree of accuracy in modelled outcomes. As such, we have assumed that the makeup of the 'alternatives' are in line with a simplified multi-asset diversified growth fund, and refer to this asset class as 'diversifiers'.

Static portfolio

A.5.35 The Panel has asked GAD to assume claimants hold a static investment portfolio over their whole investment term, as a reasonable representation of an average portfolio held over the term and have set assumptions on asset allocations with this in mind. As a result, we assume portfolios are rebalanced yearly to maintain the asset allocations at the levels they were at the start.

A.5.36 In practice, we recognise that claimants are likely to change their strategy over time, for example to reflect different investment conditions or to alter the level of risk taken (to increase certainty following periods of strong returns, to aim to recover from periods of poor returns, to reflect changes to circumstances or to reflect the fact that the remaining period of the award has reduced, etc.). Whilst it is possible to model these features within the analysis, they would not be evidenced based on what claimants do in practice, and any suitable adjustments would be highly subjective. As a result, we consider that assuming that the investment strategy remains fixed is a proportionate approach.

A.5.37 One limitation of this approach is that the range of outcomes shown is likely to be different than that which claimants might achieve should they adopt these approaches. However, we believe that the approach taken is appropriate at capturing and illustrating the overall risk profile and differences between different investment approaches. In particular, the likelihood of being over-compensated by 20% or more would be lower if we modelled claimants reducing their investment risk on periods of good returns. Also, a claimant investing over a long period of time (such as 60 years) is unlikely to not adjust their approach if the investment returns are out of line with their needs, and corrective measures would likely increase the chance of being over 90% compensated than is shown in this analysis.

Comparison to defined contribution asset portfolios

A.5.38 The Act requires that a claimant is assumed to invest using an approach that has “less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims”.

A.5.39 A defined contribution (DC) pension scheme member may be thought of as such an investor, and that the portfolios considered for defined contribution master trusts[9] could be appropriate for the assumed claimant portfolios.

A.5.40 We have compared the three core claimant overall portfolios with the default investment strategies for some of the biggest DC master trusts in the UK. While this may provide some high-level assurance, we note that they are not directly comparable due to factors such as different investment objectives and governance structures. More details on these DC strategies are given in Annex E.

[9] A master trust provides a workplace pension that can be used by many unrelated employers and their employees

A.5.41 This comparison does not raise any concerns that the proposed PIDR portfolios are higher risk than DC portfolios in general. In summary:

- **Level of risk:** The 20-year claimant overall portfolio has a similar split between higher and lower risk assets as the lowest risk DC portfolios (i.e. those at retirement age and later). As the length of the investment term increases, the percentage of higher risk assets appears to be higher in the DC master trusts than the 60-year claimant portfolio. However, this portfolio is the assumed average over the claimant's investment term, whereas a DC scheme member would transition from the default asset allocation to a lower risk portfolio over time.
- **Higher risk portfolio:** The DC portfolios have a larger proportion to overseas equities (instead of UK equities) than the claimant portfolios.
- **Lower risk portfolio:** The DC portfolios have a higher allocation to corporate bonds and, in general, a lower allocation to cash than the claimant portfolios.

A.6 Investment returns

Summary

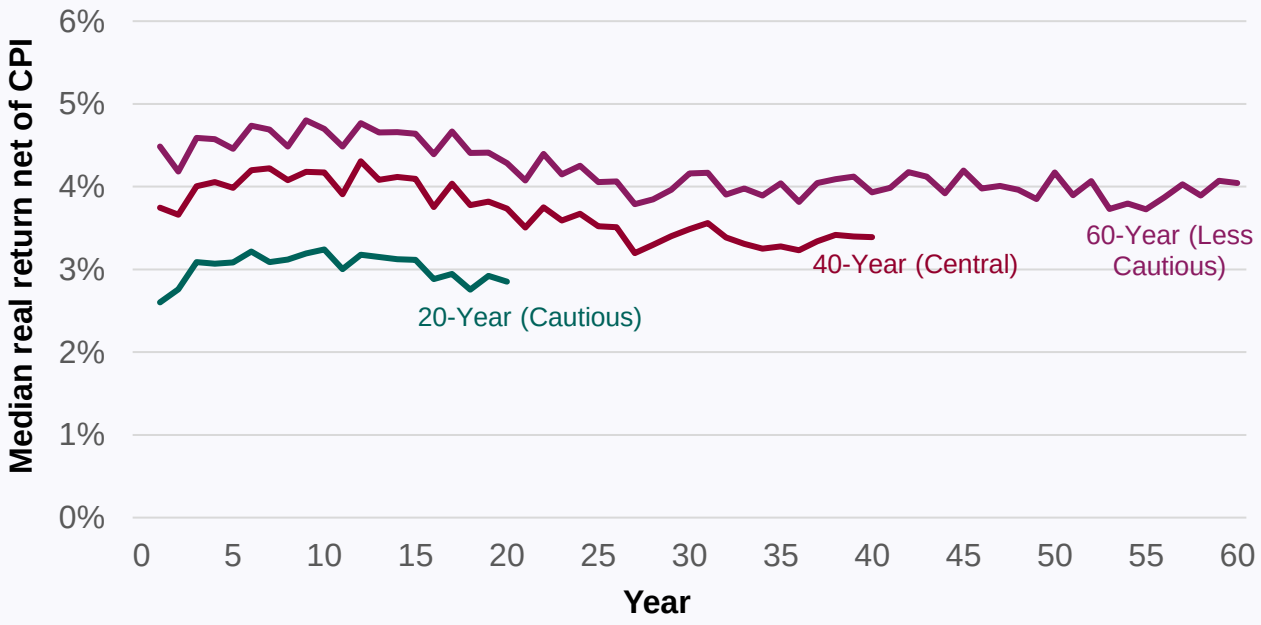
A.6.1 For each of the nine overall portfolios under consideration, Table 23 shows the 'money-weighted' annualised real returns net of CPI, on their overall portfolio allocations over the relevant term. By 'money-weighted', we mean the rate of return taking into account the size and timing of withdrawals and additions to the fund. The returns for the three core claimants are shown in bold.

Table 23: Money-weighted overall portfolio investment return net of CPI p.a. (including cash reserve)

	Investment term			
Investment strategy	**10 years**	**20 years**	**40 years**	**60 years**
Cautious	2.3%	**2.9%**	3.3%	3.4%
Central		3.1%	**3.5%**	3.6%
Less cautious			3.7%	**3.8%**

A.6.2 For each of the core claimants, Figure 12 below shows the median real return net of CPI for each year on their overall portfolios.

Figure 12: Median overall portfolio real returns, net of CPI, within each year



A.6.3 Table 24 below shows the median simulated annualised money-weighted real return (in excess of CPI) achieved for each investment term, on each of the asset classes shown in Table 22 of the 'Investment portfolio' section. It is worth noting that the weighted sum of the median asset class returns will not equal the median portfolio returns above since, for a diversified portfolio, each asset class with have a different profile of modelled returns and different correlations between asset classes.

Table 24: Median money-weighted real returns p.a. (net of CPI) by asset class and term of claimant

Asset class	10 year	20 year	40 year	60 year
Cash	1.3%	1.2%	1.0%	0.9%
Gilts	1.6%	1.9%	2.1%	2.0%
Index-linked gilts	1.3%	1.6%	1.9%	2.1%
Corporate bonds	2.3%	2.8%	3.2%	3.2%
UK equity	5.0%	4.7%	4.4%	4.3%
Overseas equities	5.6%	5.3%	5.0%	4.9%
Diversifiers	3.1%	3.1%	3.0%	2.9%

Approach

A.6.4 The income and growth generated through investment of a claimant's lump sum will depend on the investment strategy adopted and the investment term. The resulting investment return on the overall portfolio is a key component in determining the net investment return for each claimant type and an appropriate PIDR.

A.6.5 The returns on different asset classes and future CPI can be modelled stochastically[10] to give a reasonable range of potential outcomes and to help analyse the potential variability of investment returns on a claimant's overall portfolio.

To model investment returns, the Panel has asked GAD to engage with two third-party Economic Scenario Generator[11] (ESG) providers to supply stochastic simulations of asset returns and CPI inflation.

The Panel agreed that an average across the two providers' house views of returns on passive investments, for projections calibrated to economic conditions as at 31 March 2024, produced returns for the individual asset and overall portfolio returns that were reasonable and appropriate to be used to model claimants' outcomes.

Simulation approach

A.6.6 Using two simulation providers reduces the risk that a single provider's data, assumptions, or methodology contain bias that may skew the claimant analysis, though not eliminate it completely.

A.6.7 While it is preferable to use calibrated simulations that are up to date as possible, given the time taken for providers to produce them and the time available for GAD to complete the subsequent analysis, 31 March 2024 is an appropriate date to use. In the sensitivities

[10] A stochastic model produces a large number of simulations to give an estimated range of possible outcomes.

[11] An economic scenario generator (ESG) is a computer-based model of an economic environment that is used to produce simulations of the joint behaviour of financial market values and economic variables

section, we show how results would change with economic simulations calibrated to 30 September 2023 and if the simulation was started in 2029 instead of 2024. We have also monitored economic conditions since 31 March 2024 to ensure the results remain reasonable.

Provider house views

A.6.8 The Panel agreed that it is reasonable to model returns on passive investments and utilise the providers' house views of the expected level and range of those returns alongside that of CPI.

A.6.9 The Panel have considered these returns and CPI along with GAD's internal economic assumptions, other external sources, and their own expert knowledge. When considering expected returns, it is possible to take alternative views and judgements to the approach of the ESG providers, and this could lead to a materially different view of suitable PIDRs. In particular, the approach set out above is based on factors including market yields and prices, together with assumptions around when and if investment returns will return to long-term averages. Additionally, both providers consider a variety of risks and uncertainties (including systemic trends such as climate change) but essentially assumed these are priced into market instruments.

Passive versus active returns

A.6.10 In modelling the returns, claimants are expected to invest in passively managed funds i.e. funds that aim to broadly track the performance of a stated index (such as gilt, bond or equity).

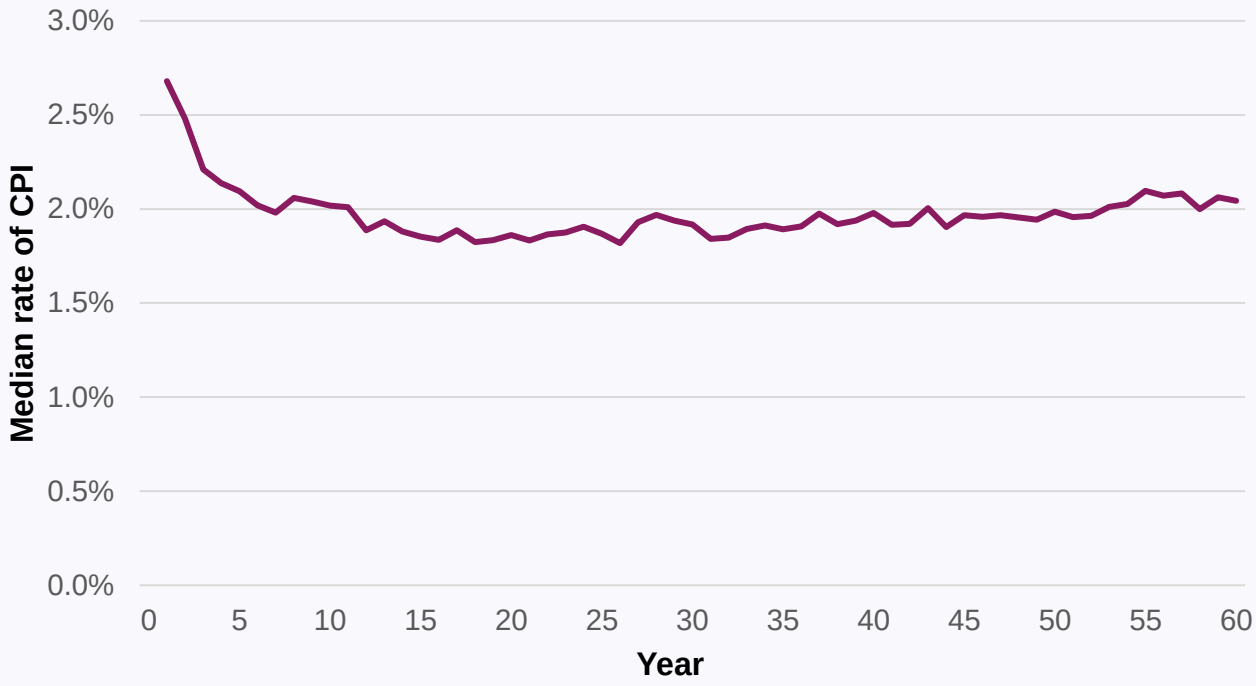
A.6.11 We acknowledge that some claimants may choose to invest in actively managed funds, but the Panel's view is that a passive investment approach is reasonable for assessing the returns that a claimant could reasonably expect.

A.6.12 The responses to the 2024 Call for Evidence from claimant representatives, highlighted that a significant proportion of claimants rely on discretionary fund management. In other words, their adviser or manager is responsible for making regular changes to their investment portfolio within a defined plan. These respondents highlighted that claimants use this type of management to reduce their downside risk but as highlighted later in the 'Expenses' sub-section of this annex, such arrangements typically have higher costs of advice. The Panel's view was that it was reasonable to not allow for any impact of active management on expected return levels (either at the median or in more downside scenarios) and correspondingly not allow for higher costs of advice.

CPI

A.6.13 The figure below shows the median rate of CPI inflation within each year across all simulations over the modelled 60-year term.

Figure 13: Median rate of CPI within each year



A.6.14 Table 25 shows the median level of simulated annual CPI inflation over various terms. Over the long-term these are slightly higher, but broadly similar to, the Bank of England's long-term inflation target of 2% p.a.[12]

Table 25: Median CPI inflation simulations

	10 years	20 years	40 years	60 years
CPI inflation over term p.a.	2.3%	2.1%	2.1%	2.1%

Annualised asset returns

A.6.15 Table 24 shows the median simulated annualised money-weighted real return (in excess of CPI) achieved on each of the asset classes. Depending on when these happen, they can have a significant impact on returns and is therefore different to a 'time-weighted' rate of return. This concept is explained further in Annex B.

A.6.16 It is worth noting that the gilts, index-linked gilts, and corporate bonds have been chosen such that their maturity dates correspond to the investment term of the claimant in question (whilst noting that there are relatively few corporate bonds with maturity dates in excess of 15 years into the future, so some re-investment is assumed). This means that the bond holdings for claimant with different term will differ and hence the expected return

[12] https://www.bankofengland.co.uk/monetary-policy/inflation

on those bond holdings will differ. For example, the 40-year / 20-year claimant is assumed to initially invest in a range of bonds that mature over their 40 / 20-year term respectively.

A.6.17 The returns overseas equities and diversifiers shown are the weighted averages of the median returns of the assets comprising these classes.

A.6.18 Returns on overseas assets are subject to volatility relating to currency fluctuations (when converting from local currency to pound sterling). Investors can choose to hedge this risk to reduce its impact, or to leave it unhedged. For our modelling, we have assumed returns are the average of hedged and unhedged positions.

A.6.19 We have also compared the return net of CPI for the 40-year claimant of 3.5% p.a. with the returns used to prepare the analysis undertaken at the 2019 PIDR review. The core of that analysis assumed a 'representative' claimant with a 43-year term and a 'Central'[13] portfolio with a median expected return net of CPI at that time of 1.9% p.a.

A.6.20 The difference of 1.6% p.a. is mainly attributable to the higher assumed asset returns at this review, particularly gilts and index-linked gilts (as discussed below), though there are also differences in portfolio allocations such as the existence of a cash reserve (which has about a 0.2% p.a. impact) and investment term (which is immaterial, with less than 0.1% p.a. impact).

A.6.21 When comparing against the annualised returns used to prepare the analysis undertaken at the 2019 PIDR review[14], looking over a 40 year term, these have changed as follows: gilts, index-linked gilts and corporate bonds have increased by around 2.5% p.a., UK equities and overseas equities have increased by around 1.5% p.a. We consider this change in the assumed asset returns reasonable given the change in economic conditions over that period.

[13] Central in the 2019 context refers to a different asset allocation to 'central' at this 2024 review.

[14] which were calibrated to economic conditions at end December 2018

A.7 Expenses

Summary

A.7.1 The total annual expense assumption depends on the portfolio (as the cash reserve is assumed to not have any expenses), investment term, and lump sum size. Table 26 summarises this for each of the core and additional claimant types (core claimant types shown in bold), showing the fees as a percentage of the overall portfolio (i.e. reducing them to allow for zero fees on the cash reserve proportion) and rounding to the nearest one decimal point.

Table 26: Expense assumptions for core and additional claimant types (p.a.)

Term (years)	Lump sum size	Investment strategy	*Advisor Fee*	*Fund manager fee*	*Platform fee*	Total
10	£500k	Cautious	*0.4%*	*0.13%*	*0.15%*	0.7%
20	**£500k**	**Cautious**	***0.55%***	***0.18%***	***0.21%***	**0.9%**
20	£500k	Central	*0.55%*	*0.18%*	*0.21%*	0.9%
20	£1m	Cautious	*0.45%*	*0.18%*	*0.19%*	0.8%
40	**£1m**	**Central**	***0.5%***	***0.21%***	***0.23%***	**0.9%**
40	£1m	Cautious	*0.5%*	*0.21%*	*0.23%*	0.9%
40	£1m	Less cautious	*0.5%*	*0.21%*	*0.23%*	0.9%
40	£500k	Central	*0.65%*	*0.21%*	*0.25%*	1.1%
40	£5m	Central	*0.25%*	*0.21%*	*0.14%*	0.6%
60	**£5m**	**Less cautious**	***0.25%***	***0.23%***	***0.15%***	**0.6%**
60	£5m	Central	*0.25%*	*0.23%*	*0.15%*	0.6%
60	£5m	Cautious	*0.25%*	*0.23%*	*0.15%*	0.6%
60	£1m	Less cautious	*0.5%*	*0.23%*	*0.24%*	1.0%
60	£10m	Less cautious	*0.25%*	*0.23%*	*0.12%*	0.6%
60	£10m	Central	*0.25%*	*0.23%*	*0.12%*	0.6%

Approach

A.7.2 A claimant investing their damages award will be subject to expenses, reducing their net investment return. In making their rate determination, the Lord Chancellor is required by legislation to assume a claimant is ‘properly advised on the investment of the relevant damages’ and ‘make such allowances for… investment management costs as the Lord Chancellor thinks appropriate’.

The Panel has agreed to reflect the impact of expenses, including financial adviser fees, fund management fees and other fees, to the returns on the invested portion of the overall portfolio. It is expected that no expenses will apply to the cash reserve. The resulting impact is then allowed for through a fixed annual percentage deduction.

A.7.3 The Panel agreed that a cash reserve could be held in a manner that does not attract any expenses, e.g. premium bonds, easy access bank accounts, etc, and therefore expenses would only apply to the invested portfolio proportion of the overall portfolio.

A.7.4 In considering an appropriate assumption for the percentage deduction applied to the invested portfolio returns, the Panel considered expenses arising from the following three elements:

- **Financial adviser fees** – Fees charged by Independent Financial Advisers for any advice provided on their investment strategy and the assets/funds which claimants should invest in.
- **Fund management fees** – Fees associated with the funds claimants invest in, including those in respect of the asset managers, custody, transaction and fund administration costs.
- **Other fees** – Including costs relating to platform fees[15] and one-off costs relating to buying/selling the underlying securities. This does not include tax costs for an individual such as income tax and capital gains tax.

A.7.5 The approach to setting the expenses is internally consistent with the approach to setting the investment strategy and investment returns. There are different approaches to investment and hence the types and levels of expenses claimants are exposed to. In particular, we are aware that claimants can use either a financial adviser or a wealth manager and have options as to how actively managed their portfolio is. As set out in the 'Investment returns' sub-section, passive investment returns have been assumed and therefore it is appropriate to consider expenses corresponding to that type of investment.

The Panel agreed to assume a passive approach to portfolio management for the purposes of estimating investment expenses.

A.7.6 In the sub-sections below, we consider these elements in turn. However, underpinning them is the assumed approach to passive investment management and we therefore cover this first.

Passive versus active

A.7.7 We acknowledge that some claimants may choose to invest in actively managed funds and that consequently pay higher fees than are assumed in this analysis, with data provided that fees could be around 1.5% to 2.0%. However, it is assumed that these higher fees are paid on the expectation of benefits to the claimant which haven't been included in this analysis and, as such, it would not be appropriate to reduce the PIDR for these higher fees.

Advisor fee

A.7.8 The Panel recognised that claimants would require financial advice and that the cost of that advice is likely to vary depending on the size of their lump sum.

[15] Payable to the platform that administers the investments

The Panel agreed that the costs of ongoing advice should vary from 0.75% p.a. for invested portfolios below £500k, decreasing to 0.25% p.a. for invested portfolios above £5m.

As such, we assume advisor fees on the invested portfolio of 0.75% p.a. for the 20-year claimant, 0.6% for the 40-year claimant and 0.3% for the 60-year claimant and zero on their cash reserves.

A.7.9 Financial adviser fees are fees charged by Independent Financial Advisers for the advice provided on their investment strategy and in which assets the claimant should invest.

A.7.10 A Financial Conduct Authority (FCA) report from 2020[16] demonstrates that the vast majority of advice is charged at precisely 0.5%, 0.75%, or 1% p.a. but that there is also a small proportion as low as 0.25% p.a.

A.7.11 It has not been made clear if these costs include VAT, which may be payable depending on specific circumstances. Therefore, the range of advice fees could be between 0.25% and 1.2% p.a. (i.e. including 20% VAT on the 1% upper end).

A.7.12 As mentioned above, we assume claimants adopt a passive approach to investment with an unchanging investment objective. Additionally, personal injury claimants are 'high quality' customers for financial advisors given their clear objectives, readily available capital for investment, large fund size, and the long-term nature of their needs.

A.7.13 It is therefore reasonable to assume claimants would be at the lower end of this range but also that the lowest possible cost would not be available to many claimants. As such, claimants with a reasonable sized invested portfolio (for example around £1m) would be subject to financial advisor fees towards the lower end of the spectrum, in the region of 0.5% p.a. However, claimants with smaller awards would typically pay more.

A.7.14 Although responses to the 2024 Call for Evidence from claimant representatives highlighted that a significant proportion of claimants rely on discretionary fund management, the cost of this discretionary advice was typically higher than would be the case for passive investment advice. As a result, this was not considered when estimating the adviser fee, in line with the discussion above.

Fund management fees

A.7.15 Fund management fees are those associated with the funds claimants invest in, including those in respect of the asset managers, custody, transaction and fund administration costs.

The Panel have asked GAD to assume fund management fees of 0.25% for all modelled invested portfolios.

A.7.16 Fund manager fees are highly dependent on the investment approach and the asset classes invested in. While industry surveys[17] suggest average costs of around 1% p.a.,

[16] https://www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf

[17] As set out in the FCA report referred to above and a NextWealth report: https://www.nextwealth.co.uk/research/financial-advice-business-benchmarks-report-2023/

this covers both active and passive approaches to portfolio management, as opposed to just the latter under consideration here.

A.7.17 To determine a more appropriate cost for the assumed investment portfolios, we have therefore analysed data on management fees for passive funds that are available to retail investors, provided to us by companies which hold such financial data. We assume these funds are collective investment funds which are exempt from VAT. The median level for our assumed portfolios was around 0.25% p.a., with minimal differences for different investment approaches.

Other fees

A.7.18 Other fees tend to be those relating to either access and administration, e.g. platform fees, or one-off costs arising from the buying or selling of the underlying securities, such as stamp duty.

A.7.19 Platform fees are the most significant of these costs. We assume stamp duty costs are included in either the fund manager fees or one-off costs, with these costs being immaterial overall.

The Panel agreed that a reasonable range for other associated costs would be 0.1% p.a. to 0.3% p.a.

A.7.20 Platform fees depend on the size of the funds invested, with percentage costs reducing as the size of investment increases. We have calculated the cost as a percentage of fund size based on platform fee information from a number of the largest providers. The average platform fee ranged from 0.1% for the largest fund size to 0.3% for the smallest fund size. This results in an estimate of average of fees (over the term and on the invested portfolio) of 0.30% for the 20-year claimant, 0.27% for the 40-year claimant and 0.17% for the 60-year claimant.

A.8 Tax and other taxable income

Summary

A.8.1 Table 27 summarises the assumed annual level of tax payable as a percentage of the fund size over the full investment term, based on the assumed 'other taxable income' for the core (shown in bold) and additional claimant types.

Table 27: Annual tax costs for core and additional claimant types

Investment term (years)	Lump sum size	Investment strategy	Other taxable income	Tax deduction p.a.
10	£500k	Cautious	£30k	0.4%
20	**£500k**	**Cautious**	**£30k**	**0.3%**
20	£500k	Central	£30k	0.3%
20	£1m	Cautious	£7k	0.3%
40	**£1m**	**Central**	**£7k**	**0.2%**
40	£1m	Cautious	£7k	0.2%
40	£1m	Less cautious	£7k	0.2%
40	£500k	Central	£30k	0.2%
40	£5m	Central	£7k	1.3%
60	**£5m**	**Less cautious**	**£7k**	**1.2%**
60	£5m	Central	£7k	1.2%
60	£5m	Cautious	£7k	1.2%
60	£1m	Less cautious	£7k	0.2%
60	£10m	Less cautious	£7k	1.5%
60	£10m	Central	£7k	1.5%

Approach

A.8.2 A claimant investing their damages award will be subject to tax on their income, dividends and capital gains, reducing their net investment return. In making their rate determination the Lord Chancellor is required by legislation to 'make such allowances for taxation… as the Lord Chancellor thinks appropriate'.

The Panel has agreed to reflect the impact of tax through an annual deduction, equal to a fixed percentage of the fund value each year. It is assumed tax is impacted by the lump sum size and other taxable income.

A.8.3 A number of respondents to the 2024 Call for Evidence provided high-level illustrative examples of claimant's potential tax liabilities, however no detailed evidence was provided to inform the overall tax drag assumption for the claimant types shown here. Given this, analysis was required to assist the Panel in reaching an appropriate assumption.

A.8.4 The approach taken was to estimate the average tax cost for each core and additional claimant type over their entire investment term. This has been done by projecting the three key drivers of tax:

- **Taxable fund value** – The lump sum is invested such that those assets generate savings income, dividends and capital gains, all subject to tax, after allowances and tax-efficient vehicles are taken into account.
- **Other taxable income** – Other forms of taxable income being received, such as earnings or pensions. This increases the tax payable on the fund.
- **Asset returns** – The level of savings income, dividends and capital gains depends on the returns of the assumed asset allocation (in particular, the split in investments between cash, bonds and equities).

A.8.5 These three factors determine the tax payable in each year, and therefore allow us to calculate an average tax drag on the fund value over a claimant's lifetime. It should be recognised that we have sought to keep the modelling as simple as possible, to give headline figures for tax drag. However, the complexity and variety of individual circumstances mean that these figures needed to be supplemented with broader judgement by the Panel in taking decisions on appropriate assumptions.

Taxable fund value

The Panel has agreed to assume that tax bands and allowances will increase in line with CPI and claimants utilise a £20k p.a. ISA allowance.

A.8.6 A claimant's taxable fund value is calculated each year. This is derived by taking the taxable fund value at the end of the previous year (or the initial lump sum in the first year) and deducting any amounts moved into tax free funds. The investment returns net of expenses are then added. This gives the taxable fund value used to derive the tax payable in that year. The tax payable and the damage payments for that year are then deducted, to give the taxable fund value at the end of the year.

A.8.7 Based on the taxable fund value, other taxable income and asset return assumptions defined above, a tax drag can be derived based on assumed tax bands and allowances in each year of the investment term.

A.8.8 When considering tax bands and allowances in future years, we consider it reasonable to assume they will increase in line with CPI over the term, as a neutral position based on current tax policy. Although income tax bands are currently frozen, this is thought to be an appropriate assumption on average over the entire investment term, especially given the wider uncertainty over future tax policy.

A.8.9 Tax-efficient vehicles can be used by claimants to reduce their tax liability, of which we consider ISAs to be most typically used. ISAs allow for a certain amount of funds to be moved into a tax-free fund each year and the limits on this depend on a claimant's personal circumstances. Children under 18 are able to transfer £9k p.a., adults are able to transfer £20k p.a., and spouses are able to pool their entitlement. As such, we assume that it is reasonable to assume claimants utilise a £20k p.a. ISA allowance. We note that there are other tax management approaches that could be utilised, especially by those with larger lump sums, such as onshore/offshore bonds. However, this is not allowed for in this analysis.

A.8.10 We assume damages payments in each year in line with the core analysis (i.e. a flat damage profile with damage inflation of CPI+1%). The size of the payment is chosen such that the claimant's funds are exhausted at the end of their investment term.

A.8.11 For simplicity, we assume returns net of expenses are around 2% p.a. for all claimants and this doesn't have a material impact on calculated tax drags through changes to the fund value.

Other taxable income

The Panel has agreed to assume other taxable income of £30k p.a. for claimants with a lump sum of £500k and other taxable income of £7k p.a. for claimants with higher lump sums. This income is assumed to increase in line with CPI.

A.8.12 For claimant types with a £500k lump sum, we assume that they continue to earn a salary or pension during the rest of their life. This is because a lower claim size suggests a higher likelihood of being able to continue in work, or suggests an older claimant who has already built up a reasonable pension. The level of other income will be highly personal to the claimant, but we consider it reasonable to assume such claimants have other income in line with the UK median of around £30k p.a.[18] and that this income would increase in line with CPI.

A.8.13 For claimants with larger lump sums, we assume that they would not be able to continue working and therefore assuming income in line with the Employment and Support Allowance[19] is reasonable. For these claimants we therefore assume other taxable income of £7k p.a., increasing in line with CPI.

A.8.14 We therefore are assuming that other taxable income is constant (net of CPI) over the whole term. However, tax impacts are greater in earlier years due to a reducing fund size and increased movement of assets into ISAs with time and therefore assuming a different income in later years wouldn't have a material impact.

Asset returns

A.8.15 A claimant's tax drag each year is sensitive to the assumed savings income, dividend income and capital gains from the assets held, and how those returns then impact how the fund value changes over time.

A.8.16 The tax analysis assumes portfolios grouped by term and set in line with the core claimant types invested portfolio. This is for simplicity, as changes between assuming a cautious versus central invested portfolio, for example, are not expected to have a material impact on the tax assumed. They have also been broadly grouped into cash (cash reserve and cash in the invested portfolio), bonds (gilts, index linked gilts and corporate bonds) and equities (UK equity, overseas equity and diversifiers). We consider these broad groupings to be sufficient to estimate the tax impacts. The four portfolios for the different terms are shown in Table 28.

[18] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2023#employee-earnings-and-hours-worked

[19] https://www.gov.uk/employment-support-allowance

Table 28: Portfolio compositions

	10-year	20-year	40-year	60-year
Cash	51%	32%	17%	12%
Bonds	29%	40%	40%	34%
Equities	20%	28%	43%	54%

A.8.17 Based on the portfolio, income and capital gains are calculated in line with the assumed asset characteristics. The assumptions largely reflect the median asset returns, weighted by the different asset types in the portfolio. For equities, the dividend yield was chosen based on consideration of historic dividend yield data (assumed around 3.5% p.a.). The capital growth was then chosen in order to sum to the median equity returns. A turnover assumption of 10% is intended to reflect a reasonable average based on a passive investment approach, i.e. a low number of transactions. The turnover determines the rate at which capital growth is realised as capital gains.

A.8.18 The return assumptions are set to be broadly consistent with the median return over the first 20-year period for the 40-year core claimant, as tax impacts are greater in earlier years due to a reducing fund size and increased movement of assets into ISAs with time. For simplicity, we assume the return assumptions are the same for all claimant types as selecting reasonable alternative assumptions has minimal impact.

Sensitivity analysis

A.8.19 Table 29 sets out how the above tax costs are expected to vary under alternative assumptions.

Table 29: Lifetime tax cost sensitivities, change in lifetime tax cost (p.a.)

Sensitivity	Core claimant type		
	20-year £500k Cautious	40-year £1m Central	60-year £5m Less cautious
Claimant assumption	**0.3%**	**0.2%**	**1.2%**
£30k other taxable income	No change	+0.3%	+0.2%
£15k other taxable income	-0.1%	+0.1%	+0.1%
No other taxable income	-0.3%	-0.1%	-0.1%
1% higher investment returns	+0.1%	+0.1%	+0.3%
Lower investment returns	-<0.1%	-<0.1%	-0.2%
2019 investment returns	-0.2%	-0.1%	-0.6%
No ISA savings	+0.3%	+0.2%	+0.3%
20-year term	No change	+0.1%	+0.2%
60-year term	-0.1%	-<0.1%	No change
£1m lump sum	+0.3%	No change	-1.0%
£500k lump sum	No change	-0.2%	-1.1%

A.8.20 Considering the sensitivities in turn:

- **Other taxable income** – This highlights that the taxable income that the claimant has from other sources has a material impact on the tax assumed.
- **Higher investment returns** – This sensitivity increases investment returns by 1% p.a. and has a material impact on the largest claims. When considering investment risk for claimants this will have a dampening effect, whereby those claimants who experience higher investment returns will also face higher tax.
- **Lower investment returns** – This sensitivity reduces investment returns by up to 0.5% p.a., depending on the portfolio (a breakdown of the sensitivity assumptions is provided below) and in line with a reasonable lower bound given current market conditions. As above, when considering investment risk for claimants this will have a dampening effect. In this case claimants who experience lower investment returns will face lower tax costs.
- **2019 investment returns** – This sensitivity assumes investment returns in line with the 2019 PIDR analysis and is therefore very different to current assumed returns. We can see again that the impact is greatest for the largest claims.

- **No ISA savings** – This sensitivity assumes claimants never use any ISA allowances. Its impact is greatest for claimants with a shorter term or a larger lump sum size, as the efficiency of ISA investments depends on the proportion of the fund that can be protected from future tax over the investment term.
- **Different terms and lump sums** – These sensitivities highlight the impact of smaller and larger lump sum sizes on different terms. It shows that the impacts are most material when assuming shorter term claimants have larger lump sums.

A.8.21 Table 30 sets out the different investment return assumptions used in the sensitivity analysis set out above.

Table 30: Investment portfolio characteristic assumptions

Item	Assumption	Sensitivity assumptions
Cash Interest	3.25%	High: 4.25% Low: 3.00% 2019: 0.50%
Bond Interest	4.75%	High: 5.75% Low: 4.25% 2019: 2.00%
Equity Dividend yield	3.50%	High: 4.00% Low: 3.25% 2019: 3.50%
Equity Capital growth	4.00%	High: 4.50% Low: 3.75% 2019: 2.00%
Equity Turnover	10.00%	10.00%

A.8.22 As set out above, the assumed claimant returns were set based on median investment return projections. However, where a claimant experiences higher than average investment returns, this will likely also result in higher tax costs, dampening the benefit of the additional return. Similarly, where a claimant experiences lower than average investment returns, this impact will likely be dampened by lower tax costs.

A.8.23 In broad terms, projected investment returns at the 75th percentile of outcomes are around 1% higher than the median, and returns at the 25th percentile are around 1% lower. From the sensitivity results above, this would not have a material impact on tax costs for the 20-year and 40-year claimant (around 0.1% higher or lower), but would have a more material impact for the 60-year claimant (around 0.3% higher or lower).

A.9 Damage profile and inflation

Summary

A.9.1 'Damage profile' refers to how a claimant's damages are assumed to change over the investment term as their financial needs change, e.g. requiring more care at older ages. It does not refer to inflationary changes. The Panel noted that this will be highly dependent on the individual claimant but that assuming a flat damage profile (i.e. assuming damages only change in line with damage inflation) is likely to be reasonable. Additionally, the sensitivity analysis shows that it does not have a material impact.

A.9.2 The rate of change of a claimant's costs irrespective of any change in financial needs is referred to as 'damage inflation'. The Panel noted that damage inflation will be highly dependent on the individual claimant but that it is reasonable to group inflationary pressures into prices and earnings inflation groupings. Considering that 65% to 85% of damages are linked to earnings, with an annual general earnings inflation assumption of between CPI+1.25% and CPI+1.5%, and evidence of upwards pressure on care worker earnings, suggests an annual damage inflation between 0.8% and 1.3% in excess of CPI would be reasonable. There was also limited evidence to suggest that damage inflation would differ significantly between the core claimant types.

The Panel has asked GAD to assume a 'flat' damage profile.

The Panel agreed to assume a fixed rate of annual damage inflation across all claimants of CPI+1%.

Approach

A.9.3 Information gathered in the 2024 Call for Evidence supported the view that the various types of heads of loss which make up overall damages inflate in line with one of the following four measures:

- **General price inflation** – Increases in the cost of consumer goods and services. This will correspond to heads of loss related to everyday spending.
- **Medical price inflation** – Increases in the cost of medical goods and services. This will correspond to heads of loss related to medical care and devices.
- **General earnings inflation** – Increases in the general level of employee wages. This will correspond to heads of loss related to lost income and pensions, as well as non-care related direct service costs.
- **Care worker earnings inflation** – Increases in the level of care worker wages. This will correspond to heads of loss related to the provision of care.

A.9.4 In arriving at an overall damage inflation assumption, the Panel first established their views on assumptions for each of the inflation measures described above. They then took a weighted average of these, with the weightings reflecting, for each claimant type, the proportion of damages they believe is linked to each measure.

A.9.5 Their considerations and conclusions are summarised further below.

General price inflation: the Panel agreed to assume that this is best represented by CPI.

Medical price inflation: due to the limited evidence and the limitations of available medical price measures, the Panel agreed that this could reasonably be in line with general price inflation and therefore best represented by CPI, or could reasonably be in line with general or care worker earnings inflation.

General and care worker earnings inflation assumptions

A.9.6 As part of our considerations in determining these assumptions, we analysed indices of both general and care worker earnings over time.

A.9.7 The general earnings inflation indices considered were the Average Weekly Earnings[20] index (AWE) and the Annual Survey of Hours and Earnings[21] (ASHE). Care worker earnings inflation indices considered were the 10th percentile and the 80th percentile of ASHE 6115, which reflects care workers specifically.

A.9.8 The Panel noted that there appeared to be no significant differences between these two sets of inflation measures over the long term.

A.9.9 Some responses to the 2024 Call for Evidence did highlight reasons that future care worker earnings may be subject to different inflationary increases than general earnings. The Panel considered that there may be upwards pressure on care worker earnings inflation, but would reflect this in the overall assumption. As a result, the Panel agreed to use a single assumption to reflect both general earnings and care worker earnings inflation.

A.9.10 GAD's internal pension scheme guidance assumes the median rate of earnings inflation over the next 15 to 20 years is 1.25% p.a. above CPI as at the end of March 2024. In the responses to the 2024 Call for Evidence, views of future inflation of general earnings and care earnings were generally between CPI+1.25% and CPI+1.75%.

The Panel agreed that a reasonable range for future general earnings inflation would be between CPI+1.25% to CPI+1.5%, and that there is evidence of upwards pressure on care worker earnings.

Proportion of damages linked to earnings

A.9.11 Respondents to the 2024 Call for Evidence submitted data on the split of lump sum awards by different heads of loss.

A.9.12 An important limitation of this data is that the exact split between the various heads of loss is not necessarily defined at settlement. As a result, it is based on interpretation of case files and we are reliant on the (unverifiable) view that respondents applied their impartial

[20] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours

[21] https://www.ons.gov.uk/surveys/informationforbusinesses/businesssurveys/annualsurveyofhoursandearningsashe

best estimate during the process. Additionally, the degree to which PPOs were included in the data was not always explicit or clear.

A.9.13 The key piece of evidence was provided by the Forum of Complex Injury Solicitors (FOCIS). Analysis of this suggested the proportion of damages linked to earnings was in the range 75% to 81%, depending on whether medical costs are considered earnings-related or not. The average proportions are up to 89% for the largest claim sizes and as low as 66% for others.

A.9.14 The ABI also provided data reflecting a representative sample of the motor and liability insurance market. Analysis of this suggested the proportion of damages linked to earnings was in the range 69% to 81%, depending on whether medical costs are considered earnings-related or not. The average proportions are up to 85% for some claim sizes and as low as 64% for others.

A.9.15 Data from NHS R relating to clinical negligence claims suggested a lower proportion of damages linked to earnings – around 64 to 69%, assuming medical costs are earnings-related. If medical costs were assumed to be price-related, this proportion was even lower – around 34% to 37%.

A.9.16 These relatively lower proportions quoted by NHS R can be explained by the fact that claims settled by NHS R include a much higher proportion of cases where part of the settlement is via a lump sum and part is in the form of a PPO.

A.9.17 In these cases, the parts settled by PPO are generally all related to care and case management. This means that the remaining lump sums on which the data provided is based, are less earnings linked than they would have been without the presence of PPOs alongside.

A.9.18 The proportion of damages linked to earnings may also be influenced by the level of future take-up of PPOs. However, without strong evidence relating to its potential impact, it may not be appropriate for an allowance to be made in this regard.

The Panel agreed that, given the uncertainty in this assumption, a reasonable range for the proportion of damages linked to earnings would be 65% to 85%.

Annex B: Methodology

This Annex describes the calculation methodology underlying the analysis in this report.

B.1 Approach

B.1.1 Our approach is to quantify a claimant's 'compensation level' under specific PIDRs, in terms of whether the claimant has sufficient funds to meet their future financial needs and, where the funds do not exactly meet these needs, quantifying the extent of any excess or shortfall.

B.1.2 The analysis is built up in two stages. Firstly, to quantify what we refer to in this report as the 'net investment return' of claimants – that is the median investment return net of expenses, tax, and damage inflation over their remaining lifetime. Secondly, to allow for uncertainty in claimant outcomes, through sensitivity analysis on the assumptions adopted and modelling a range of economic conditions.

B.1.3 To estimate suitable PIDRs, we consider how the claimant's fund might evolve over time under Monte Carlo (or 'stochastic') simulations for future asset returns and inflation. Monte Carlo simulations are a way of calculating or forecasting possible results and assessing risk by running a large number of simulations. This allows us to:

- show the range of potential outcomes;
- estimate a distribution of outcomes and different percentiles of this distribution; and
- estimate the probability of outcomes being worse or better than a given level.

B.2 Net investment returns

Outline of calculations

B.2.1 Making regular withdrawals from a fund can have a significant impact on the effective returns achieved and the analysis therefore includes projections of the fund size.

B.2.2 The analysis projects the fund of a claimant type over a defined term, using 4,000 stochastic economic simulations[22] of future asset returns and CPI inflation.

[22] The number of scenarios determined to be sufficient to produce consistent outputs across different samples

B.2.3 The fund at the end of each year in each economic scenario will be determined with regard to:

- the fund value at the beginning of the year in that simulation;
- increases to allow for the returns (in that simulation/year) on the investments held, including both capital growth (i.e. changes in price) and income (e.g. dividends or coupons); and
- reductions for withdrawals made from the fund to meet damages (which are inflated in line with projected inflation in the simulation).

B.2.4 The steps to calculate a claimant's median net investment return over all simulations are:

- For each simulation, we calculate the initial fund value that results in a fund that is perfectly exhausted at the end of the investment term with no surplus or shortfall. In other words, the initial fund value that gives the claimant 100% compensation.
- For each simulation, we calculate an equivalent constant annual return over the investment term, which we refer to as the money-weighted rate of return (MWRR).
- We determine the median MWRR out of the 4,000 scenarios. We expect that the claimant has a 50% likelihood of earning a greater MWRR than this (in 2,000 out of 4,000 scenarios). We refer to this median MWRR as the 'median investment return'.
- We derive the median net investment return by applying fixed assumed deductions for expenses, tax, and damage inflation to the median investment return.

Illustrative example

B.2.5 This process is perhaps best demonstrated by a simplified illustrative example. We assume that the claimant needs to meet fixed damages of £10,000 in the next two years. In this example, we ignore the effect of inflation on damage payments and investment returns, though the principle would be the same if inflation were included.

B.2.6 We project investment returns over six economic scenarios. For each scenario, we calculate the constant annual return that would give the same fund value at the end of the two-year term. This is the money-weighted rate of return and represents the average return achieved over the term, allowing for the fund size at each point in time. The illustrative returns in each of the two years and the resulting MWRR are as follows:

Table 31: Illustrative investment returns

Economic scenario	Return in year 1	Return in year 2	Money-weighted rate of return p.a.
1	11%	1%	**8.5%**
2	-6%	18%	**-0.5%**
3	20%	-11%	**11.5%**
4	2%	3%	**2.3%**
5	-3%	-10%	**-4.8%**
6	5%	5%	**5.0%**

Note these scenarios are only illustrative and are not intended to be representative of the projected range of returns.

B.2.7 This illustration would give a median MWRR, or median investment return, of 3.6% p.a. (calculated by averaging the MWRRs for the two scenarios with MWRR in the middle of the range, scenarios 4 and 6).

B.2.8 Finally, we make deductions for expenses and tax. For this illustrative example only, suppose we assumed the claimant's combined expenses and tax costs were 1.0% p.a.

B.2.9 The median net investment return would therefore be equal to 3.6% – 1.0% = 2.6% p.a.

B.3 Level of under- or over-compensation

B.3.1 Our approach here is to quantify a claimant's 'compensation level' in terms of whether the claimant has sufficient funds to meet their future financial needs and, where the funds do not exactly meet these needs, quantifying the extent of any excess or shortfall. The compensation level will depend on the PIDR used to calculate the claimant's lump sum.

B.3.2 The steps to calculate a claimant's compensation level for each economic scenario under a given PIDR are:

- Calculate the initial fund value that would result in a fund value that is perfectly exhausted at the end of the investment term with no surplus or shortfall. In other words, it is the initial fund value that gives the claimant sufficient (100%) compensation. This does not make an allowance for annual costs of expenses and tax.
- For a given PIDR, derive the 'adjusted' discount rate by effectively reversing the percentage deductions for expenses and tax that were applied to derive the PIDR. This is done to maintain consistency with the initial fund value calculation in the previous step, which does not allow for expenses or tax.
- Using this adjusted discount rate, calculate the 'adjusted' lump sum as the present value of expected future damages.
- Calculate the compensation level as the ratio between the initial fund value and the 'adjusted' lump sum size.

B.3.3 If the lump sum awarded in practice is larger than the amount required then, the claimant will have surplus funds at the end of the term, and is described as 'over-compensated' with a compensation level over 100%. On the other hand, if the amount is less than required than the claimant will have a shortfall and is described as 'under-compensated' with a compensation level below 100%. This comparison will be calculated for each scenario, meaning that a distribution of outcomes is derived.

Illustrative example

B.3.4 We demonstrate this calculation using the same simplified illustrative example as before. We assume that the claimant needs to meet fixed damages of £10,000 in the next two years.

Calculate initial fund value for sufficient compensation

B.3.5 To calculate the initial fund value that gives the claimant 100% compensation, we need to work backwards from a final fund value at the end of the investment term of exactly £0, and calculate the fund value going back one year at a time.

B.3.6 Assuming withdrawals from the fund occur half-way through the year, and investment returns on the fund are achieved uniformly over the year, we calculate the fund value one year prior as:

Fund value at start of year = [Fund value at end of year + £10,000 x (1 + return)$^{1/2}$] / (1 + return)

B.3.7 In this illustrative example, the fund value at the end of year 1 (or start of year 2) in scenario 1, based on a return over the year of 1%, is calculated as:

£9,950 = [£0 + £10,000 x (1 + 1%)$^{1/2}$] / (1 + 1%)

Table 32: Calculating initial fund value for sufficient compensation

	Fund value		
Economic scenario	End of year 2	End of year 1	Initial fund value for sufficient compensation
1	£0	£9,950	£18,456
2	£0	£9,206	£20,108
3	£0	£10,600	£17,962
4	£0	£9,853	£19,562
5	£0	£10,541	£21,020
6	£0	£9,759	£19,053

B.3.8 Note that for the fund to be perfectly exhausted at the end of year 2 (i.e. there is no surplus or shortfall), a different starting fund value is required in each scenario to reflect the different returns simulated within each scenario.

Calculate the 'adjusted' lump sum under a given PIDR

B.3.9 In practice, a claimant's lump sum under a given PIDR is calculated by discounting expected future damages by the PIDR to get a present value. The claimant's compensation level would be the ratio between the actual lump sum received and the lump sum that would be perfectly exhausted at the end of their lifetime after investment returns and deductions for withdrawals, expenses and tax.

B.3.10 However, in our calculation, we effectively estimate the PIDR without a deduction for expenses and tax and then add this on separately, as a fixed adjustment.

Calculate the compensation level

B.3.11 For each economic scenario, we calculate the compensation level as the ratio between the initial fund value and the lump sum size.

B.3.12 Table 33 shows how the compensation level is calculated for each of the six scenarios in our illustrative example.

Table 33: Example of compensation level calculation

Economic scenario	Lump sum awarded under PIDR of -1% (discounting at 0%) (A)	Lump sum sufficient compensation (B)	Compensation level (A / B)
1	£20,000	£18,456	108%
2	£20,000	£20,108	99%
3	£20,000	£17,962	111%
4	£20,000	£19,562	102%
5	£20,000	£21,020	95%
6	£20,000	£19,053	105%

B.3.13 An alternative interpretation of the over/under-compensation figures presented above is the extent to which the claimant would need to scale back, or could boost, their expenditure. In scenario 1, the claimant would be able to boost their need expenditure by 8%, whereas in scenario 5 the claimant would have to scale back their expenditure by 5%, or find alternative sources of income.

B.3.14 Over a much larger set of 4,000 scenarios, these calculations result in a distribution of claimant outcomes under a given PIDR which can be used to assess, for example:

- the likelihood that a claimant achieves at least sufficient (100%) compensation;
- the likelihood that a claimant achieves higher or lower than a specified level of compensation; and
- a claimant's potential range of compensation levels.

Annex C: Further sensitivity analysis

Summary

C.1 In Section 6 of the report, we show the sensitivity impact of alternative expenses, tax, and damage inflation assumptions to the 40-year claimant and for tax on the 60-year claimant. These are summarised in Tables 34 and 35 below followed by our rationale for each.

Table 34: Impact on 40-year claimant median net returns of alternative assumptions

Assumption	Claimant assumption (p.a.)	Alternative assumption reasonable range (p.a.)		Impact on median net return (p.a.)
Expenses	0.9%	High	1.8%	**-0.9%**
		Low	0.5%	**+0.4%**
Damage inflation	CPI+1.0%	High	CPI+1.3%	**-0.3%**
		Low	CPI+0.8%	**+0.2%**
Tax	0.2%	High	0.7%	**-0.5%**
		Low	0.0%	**+0.2%**

Table 35: Impact on 60-year claimant median net return of alternative tax assumption

Assumption	Claimant assumption (p.a.)	Alternative assumption reasonable range (p.a.)		Impact on median net return (p.a.)
Tax	0.9%	High	1.7%	**-0.5%**
		Low	0.2%	**+1.0%**

Expenses

C.2 As shown in Table 6 of Section 4, the best-estimate expense assumption for the 40-year claimant is 0.9% p.a. This represents the cost of financial advice, investment management and other expenses such as platform fees and are only assumed to apply to the invested portfolio.

C.3 The advisor fee of 0.5% p.a. is its largest component and this fee could reasonably be as high as 1% p.a. plus VAT if applicable, i.e. 1.2% p.a., or as low as 0.25% p.a. The other two components, fund manager and platform fees, could be around 0.2% p.a. higher or lower than the assumed 0.4% p.a. This translates into a reasonable range of 0.2 to 0.6% p.a. Combined expenses could therefore potentially be as high as 1.8% p.a. or as low as 0.5% p.a. The above is discussed further in the ‘Expenses’ section of Annex A.

Damage inflation

C.1 This depends on two key underlying assumptions, namely the proportion of losses that are earnings-related and the future earnings inflation associated with them.

C.2 When considering the 40-year claimant, reasonable ranges which have been agreed by the Panel for each of these are:

- Proportion of earnings-related losses: 65% to 85%
- Future earnings inflation: CPI+1.25% p.a. to CPI+1.5% p.a.

C.3 Combining these gives a reasonable range of annual damage inflation between CPI+0.8% and CPI+1.3% (when rounded to the nearest 0.1%) compared to the assumption of CPI+1%.

C.4 It should be noted that these assumptions are highly subjective and there are wider economic and political factors that can impact future care costs and other earnings-related losses, so in practice the level of inflation a claimant faces may fall outside of this range.

Tax

C.5 As shown in Table 6 of Section 4, the tax drag assumption for the 40-year claimant is 0.2% p.a.

C.6 However, should their other taxable income be lower than we have assumed, or if they use other tax-efficient vehicles in addition to ISAs, they could reasonably pay very little or no tax.

C.7 On the other hand, if other taxable income is higher or if ISAs are not utilised (or not able to be utilised), tax costs could reasonably be 0.5% p.a. higher.

C.8 This translates into a reasonable range of 0% to 0.7% p.a. for the tax drag assumption, whilst recognising the limitations of the tax analysis mentioned previously and assuming that there are no changes to the tax policy over time.

C.9 The best-estimate tax drag assumption for the 60-year claimant is 1.2% p.a.

C.10 Uncertainty exists around this assumption and should tax-efficient investment vehicles be available, a tax drag assumption of 0.2% could be plausible, which would be equivalent to that assumed for the ‘60-year: £1m’ claimant.

C.11 On the other hand, if there is a higher level of other taxable income than assumed under the best-estimate assumption, or if ISAs are not utilised, a tax drag assumption of 1.7% could be plausible.

C.12 The above is discussed further in ‘Tax and other taxable income’ section of Annex A.

Annex D: Further breakdowns of compensation levels

D.0 This annex sets out further analysis on ranges of over-compensation and under-compensation, and the likelihoods associated with these under different PIDRs. This is to provide the Panel, and subsequently the Lord Chancellor, a fuller data set on which key components have been drawn out in this report, alongside alternative framing of the analysis.

D.1 Impact of different PIDRs on compensation levels

D.1.1 The Figures 14 to 16 below show the probability ranges of compensation over 120% (in **orange**), compensation between 100% and 120% (in **dark green**), compensation between 90% and 100% (in **light green**) and compensation under 90% (in **red**), for an expanded range of PIDRs compared to those shown in the body of the report, for the core claimants in turn.

D.1.2 These show that:

- Even at very low PIDRs, it is not possible to achieve a 100% likelihood of greater than 90% compensations for all claimants.
- Increasing the investment term and investment risk (in going from a 20-year to 40-year to 60-year claimant) increases the variability of outcomes, as shown by the width of the 90 to 120% compensation bands (i.e. the likelihood of achieving this level) narrowing between Figures 14 to 16.
- Reducing the PIDR consistently reduces the likelihood of significant under-compensation (i.e. below 90% compensation) but also increases the likelihood of significant over compensation (i.e. above 120% compensation).

Figure 14: Likelihood of over/under compensation under differing PIDRs: 20-year claimant

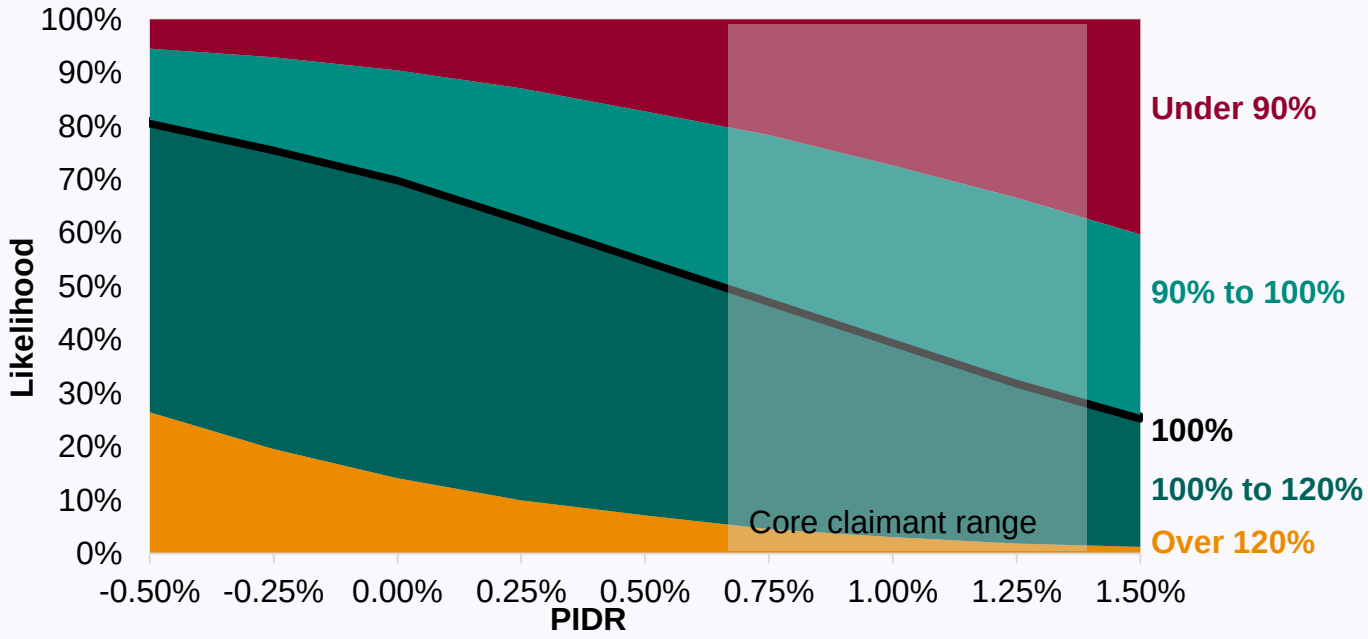


Figure 15: Likelihood of over/under compensation under differing PIDRs: 40-year claimant

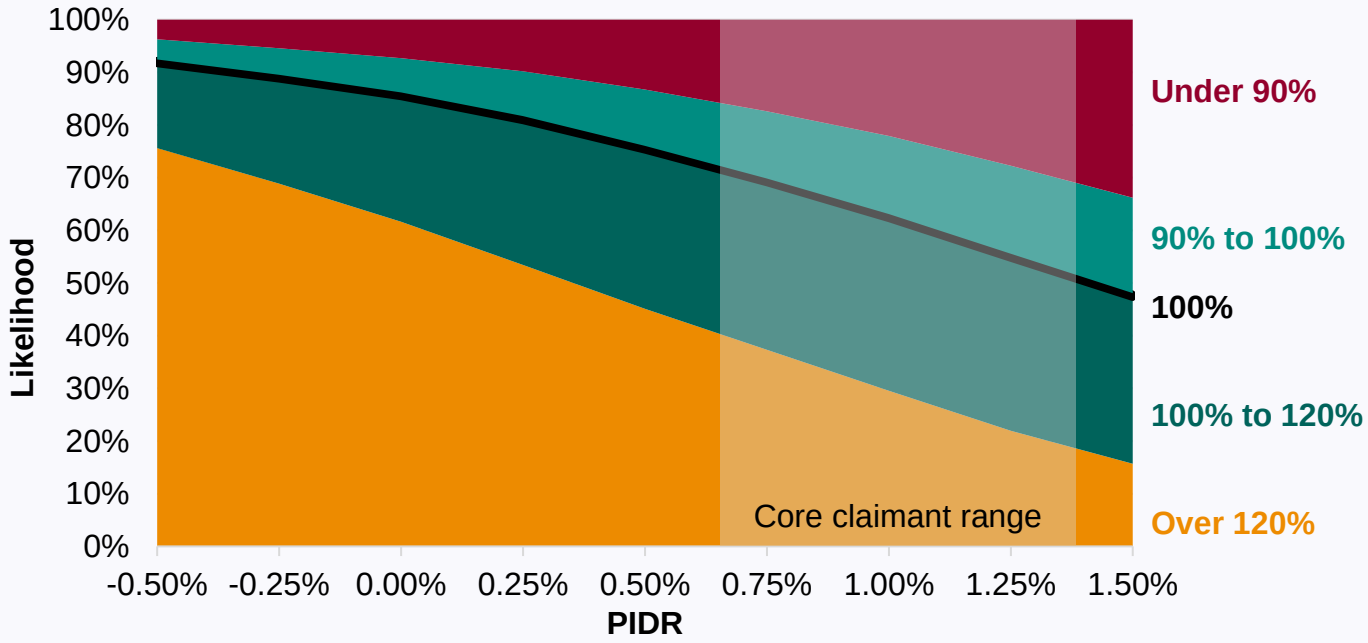
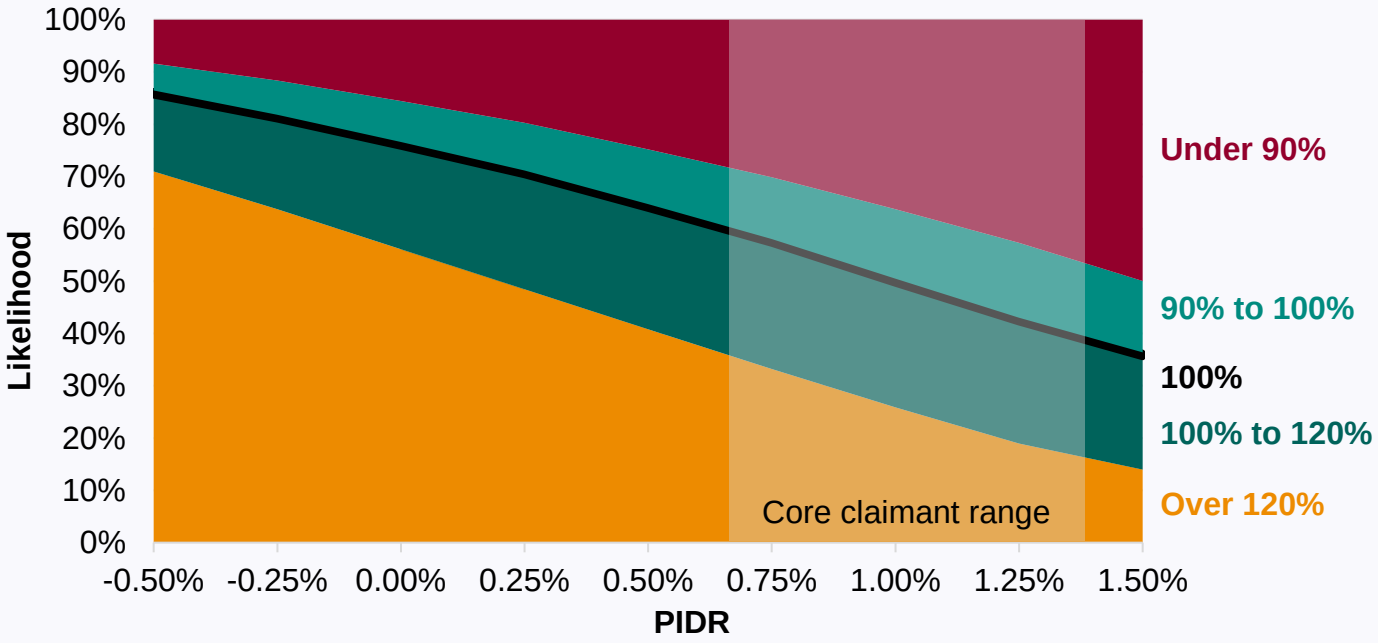


Figure 16: Likelihood of over/under compensation under differing PIDRs: 60-year claimant



D.1.3 Table 36 shows percentages, taken from the above figures, of the likelihood of receiving different levels and above of compensation (of at least 90%, 100%, 110%, 120% and 130%) for a range of PIDR and the three core claimant types.

Table 36: Likelihood of achieving a compensation level of at least different levels

	20-year claimant				
PIDR	Likelihood of achieving a compensation level of at least…				
	90%	100%	110%	120%	130%
-0.25%	93%	76%	47%	20%	6%
0.50%	83%	55%	24%	7%	2%
0.75%	78%	47%	18%	5%	1%
1.00%	73%	40%	13%	3%	1%
1.25%	67%	32%	9%	2%	0%
1.50%	60%	25%	7%	1%	0%

PIDR	40-year claimant				
	Likelihood of achieving a compensation level of at least…				
	90%	100%	110%	120%	130%
-0.25%	95%	89%	80%	69%	55%
0.50%	87%	76%	61%	45%	31%
0.75%	83%	69%	53%	37%	23%
1.00%	78%	63%	45%	30%	16%
1.25%	72%	55%	38%	22%	12%
1.50%	66%	48%	30%	16%	8%

PIDR	60-year claimant				
	Likelihood of achieving a compensation level of at least…				
	90%	100%	110%	120%	130%
-0.25%	88%	81%	73%	64%	54%
0.50%	75%	64%	52%	41%	30%
0.75%	70%	58%	44%	33%	22%
1.00%	64%	50%	37%	26%	16%
1.25%	57%	43%	30%	19%	11%
1.50%	50%	36%	23%	14%	8%

D.1.4 This report highlights analysis showing that for the 20-year claimant, whilst there is a lower probability of achieving at least 100% compensation than for the other core claimants, there is a relatively high likelihood of achieving at least 90% compensation, on each of the PIDRs shown. This is also true to a greater extent for the 10-year claimant, as shown by Table 37, which shows the likelihood of the 10-year claimant receiving at least compensation of 90% and 100%, under the same PIDRs.

Table 37: Likelihood of achieving compensation levels for 10-year claimant

PIDR	10-year claimant	
	Likelihood of achieving a compensation level of at least…	
	90%	100%
-0.25%	95%	63%
0.50%	88%	42%
0.75%	85%	35%
1.00%	82%	28%
1.25%	78%	22%
1.50%	73%	17%

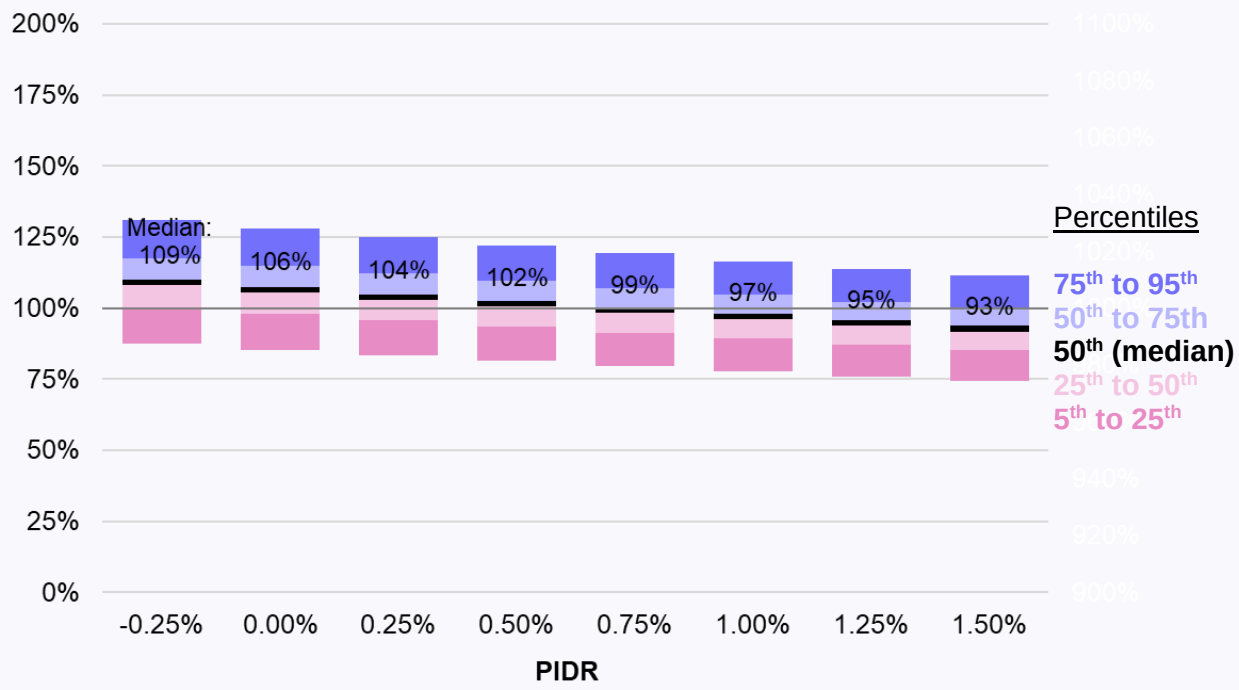
D.2 Variability of compensation levels under specific PIDRs

D.2.1 The above considers the likelihood of various ranges of over/under-compensation under differing PIDRs, alternatively we can consider the level of and variability in percentage compensation for each claimant type under differing PIDRs.

D.2.2 The Figures 17 to 19 below show bars of the range of compensation levels from the lower 5th percentile[23] of expected outcomes (bottom of the **pink section**) to the upper 95th percentile (top of the **blue section**), for a range of PIDRs. Each bar therefore represents 90% of expected outcomes for each claimant under a given PIDR, with 5% being below the bottom of the pink and above the blue sections respectively. The median compensation levels are indicated by the grey line.

D.2.3 The figures show the same analysis as shown in section D.1 but highlights the upper and lower bounds of the compensation levels. For example, it highlights the wider range of possible compensation levels for a 60-year claimant and that very high over-compensation is plausible with lower PIDRs.

Figure 17: Range of compensation levels by claimant type and PIDR: 20-year claimant



[23] The Xth percentile represents the compensation level below which X% of the modelled economic simulations are expected to lie, i.e. the claimant is expected to have X% likelihood of achieving this compensation level or lower.

Figure 18: Range of compensation levels by claimant type and PIDR: 40-year claimant

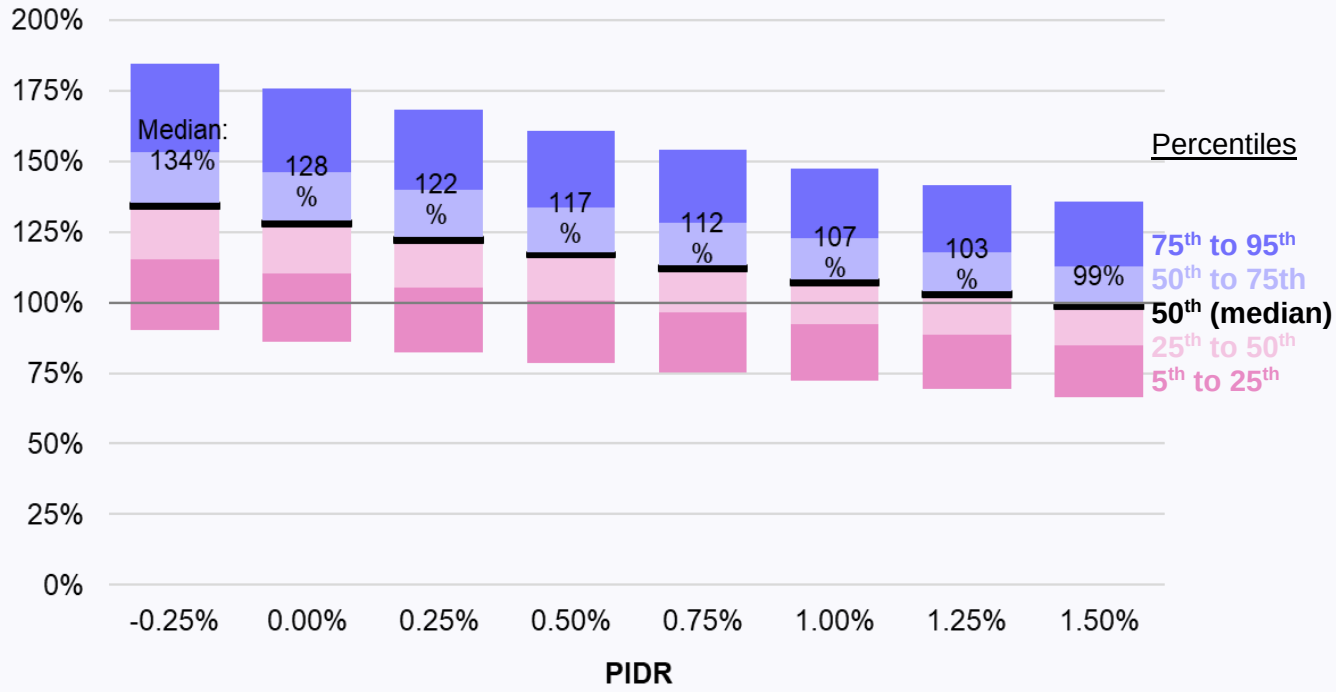
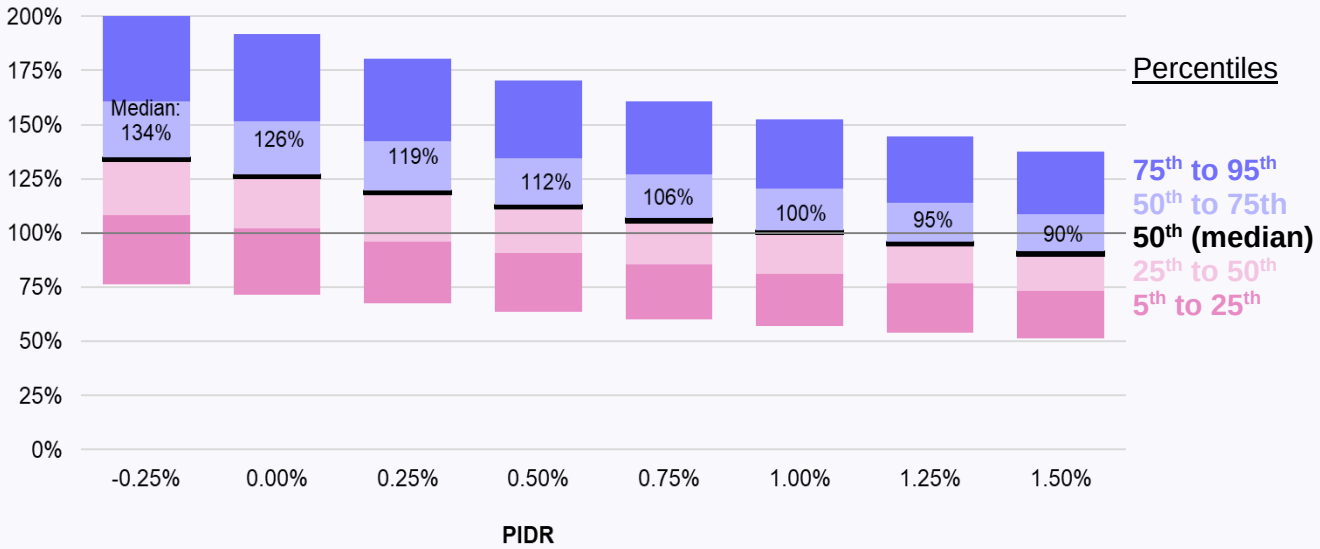


Figure 19: Range of compensation levels by claimant type and PIDR: 60-year claimant



D.2.4 To enable a more direct comparison between core claimants, Figures 20 and 21 illustrate the range of expected compensation levels for the three core claimant types under PIDRs of 0.75%, 1% and 1.25%, grouped by PIDRs in Figure 20 and by core claimant in Figure 21. These highlight that for the 20-year claimant the median compensation level is close to 100% for PIDRs between 0.75% and 1.25% and that the range of outcomes is a lot narrower than for the other core claimants.

Figure 20: Ranges of compensation levels for by PIDR and core claimant type

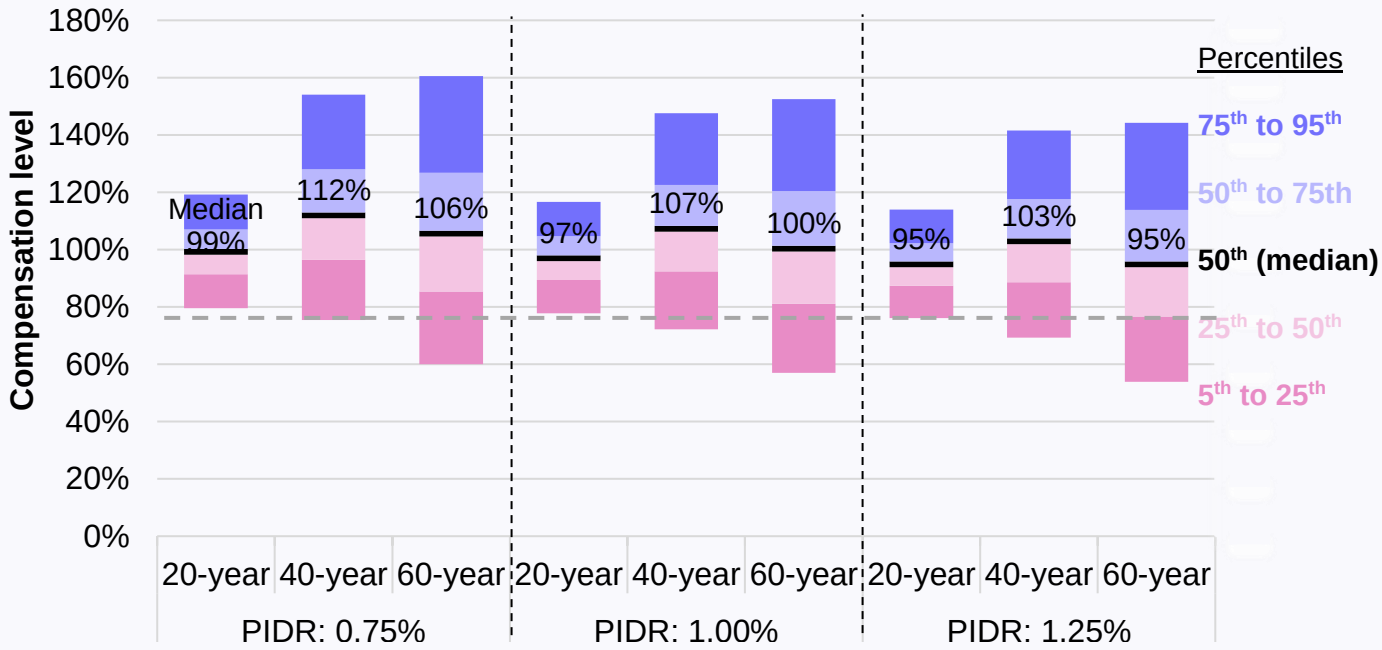
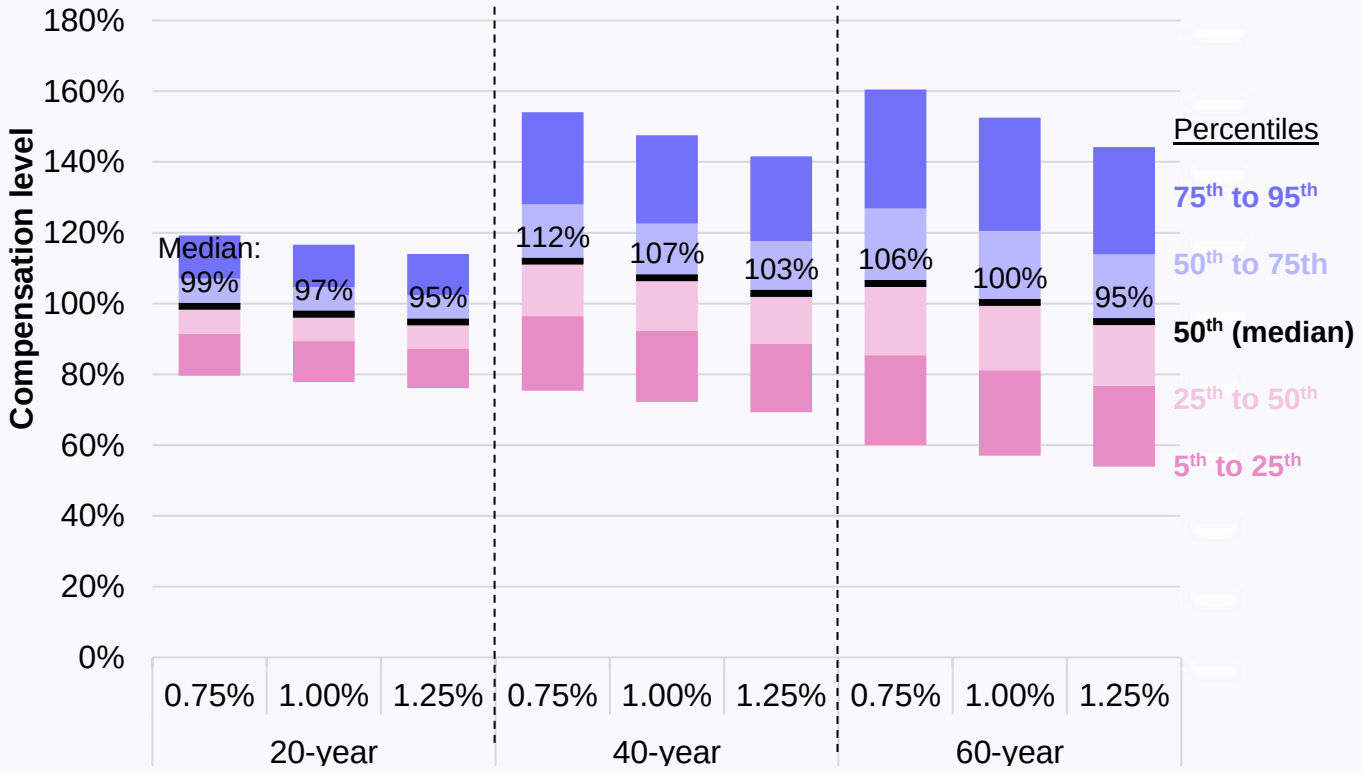


Figure 21: Range of compensation levels by claimant type and PIDR



D.2.5 Table 38 draws out from Figure 19 the expected compensation levels at the 25th, 50th (median), and 75th percentiles. The colour of each cell in the table corresponds to the range of compensation levels discussed earlier in the section, i.e. under 90% of sufficient compensation (**red**), between 90% and 120% (**green**), and over 120% (**orange**)[24].

Table 38: Expected compensation levels

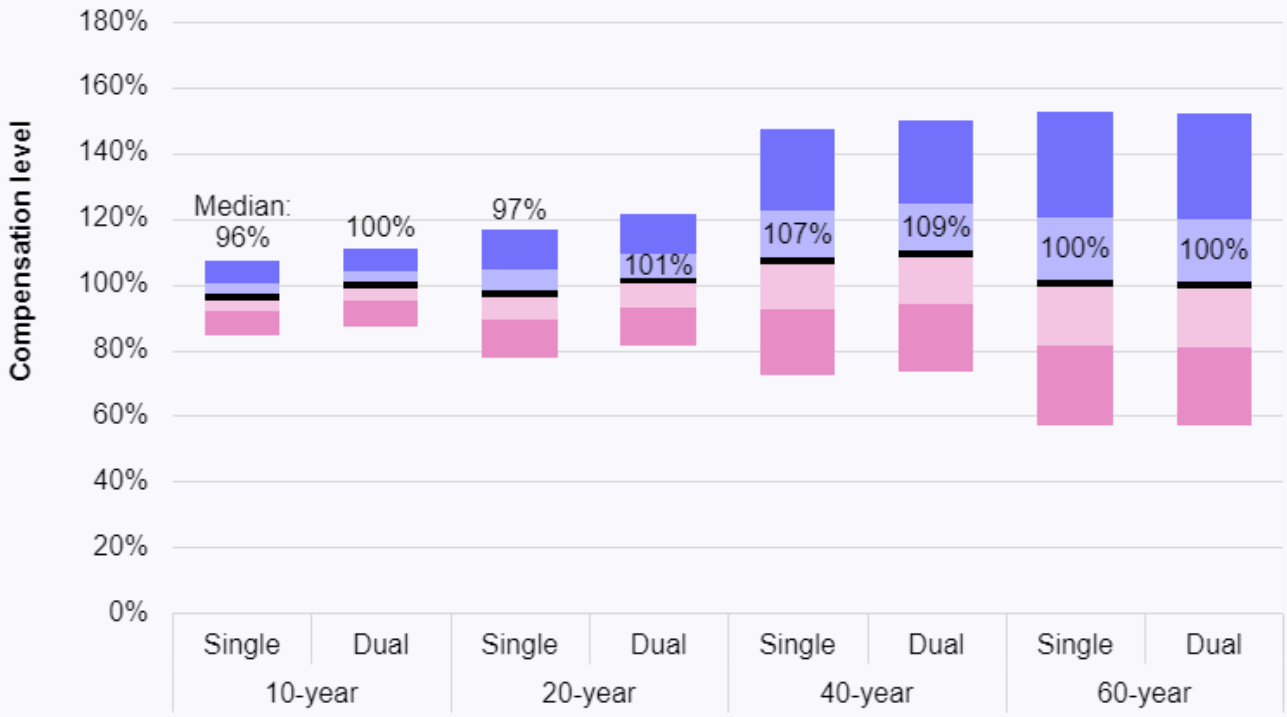
	Core claimant type								
	20-year			40-year			60-year		
PIDR	75%...	50%...	25%...	75%...	50%...	25%...	75%...	50%...	25%...
	…likelihood of achieving a compensation level of at least…								
-0.25%	100%	109%	118%	115%	134%	153%	108%	134%	161%
0.50%	94%	102%	110%	101%	117%	134%	91%	112%	135%
0.75%	91%	99%	107%	96%	112%	128%	86%	106%	127%
1.00%	89%	97%	105%	92%	107%	123%	81%	100%	120%
1.25%	87%	95%	102%	89%	103%	118%	77%	95%	114%
1.50%	85%	93%	100%	85%	99%	113%	73%	90%	109%

[24] As highlighted in the limitations in paragraphs 5.17-5.19, these figures have generated by an approximate allowance for tax and expense given that these are fixed additions to the stochastic model. As such, the figures could be between the mid-point of the PIDR figures on either side. For example, the 20-year 75% figure for a 1% PIDR could be between 88% and 90%.

Single rate versus dual rate considerations

D.2.6 The figure below compares the range of compensation levels between the illustrative singe rate (of 1%) and a dual rate of (0.25% short and 1.5% long). It shows that whilst the dual rate can shift the median outcome up for shorter term claimants, it doesn't have a significant impact on the ranges of outcomes (**dark blue** is 75th-95th percentiles, **light blue** is 50th-75th percentiles, **light pink** is 25th-50th percentiles and **dark pink** is 5th-25th percentiles).

Figure 22: Range of compensation levels comparing a single and dual rate



Annex E: Defined contribution master trust investment strategies

E.1 This annex sets out additional information for the Panel covering defined contribution master trust investment strategies as a comparator of a 'prudent and properly advised individual investor who has different financial aims', as set out in the Act.

E.2 A defined contribution pension scheme member could be considered as such an appropriate comparator investor, and that the portfolios considered for defined contribution master trusts, as being appropriate for those investors. As such, we have collated the default investment strategies for some of the biggest defined contribution (DC) master trusts[25] in the UK and list the master trusts used, with links to their factsheets at the end of this annex.

E.3 A comparison of these to assumed personal injury claimant portfolios may provide some high-level assurance, but they are not directly comparable due to factors such as different investment objectives and governance structures. For example:

- DC savers will have changing investment objectives, as they move from the period before retirement, to the period at retirement, and into retirement. They do not expect to liquidate any assets before retirement and will re-invest any income until close to retirement. So they should be able to take more risk during the pre-retirement period.
- Personal injury claimants may have bigger individual pots than DC investors, but DC investors benefit from the master trust total assets being much larger than a typical personal injury claimant, so they will be able to access a wider range of investments and more attractive commercial terms.
- Personal injury claimants are likely to be more vulnerable and may have a different appetite to risk than a typical DC saver.
- DC master trusts have to be approved and regulated by the Pensions Regulator and are run by trustee boards that must take professional investment advice.

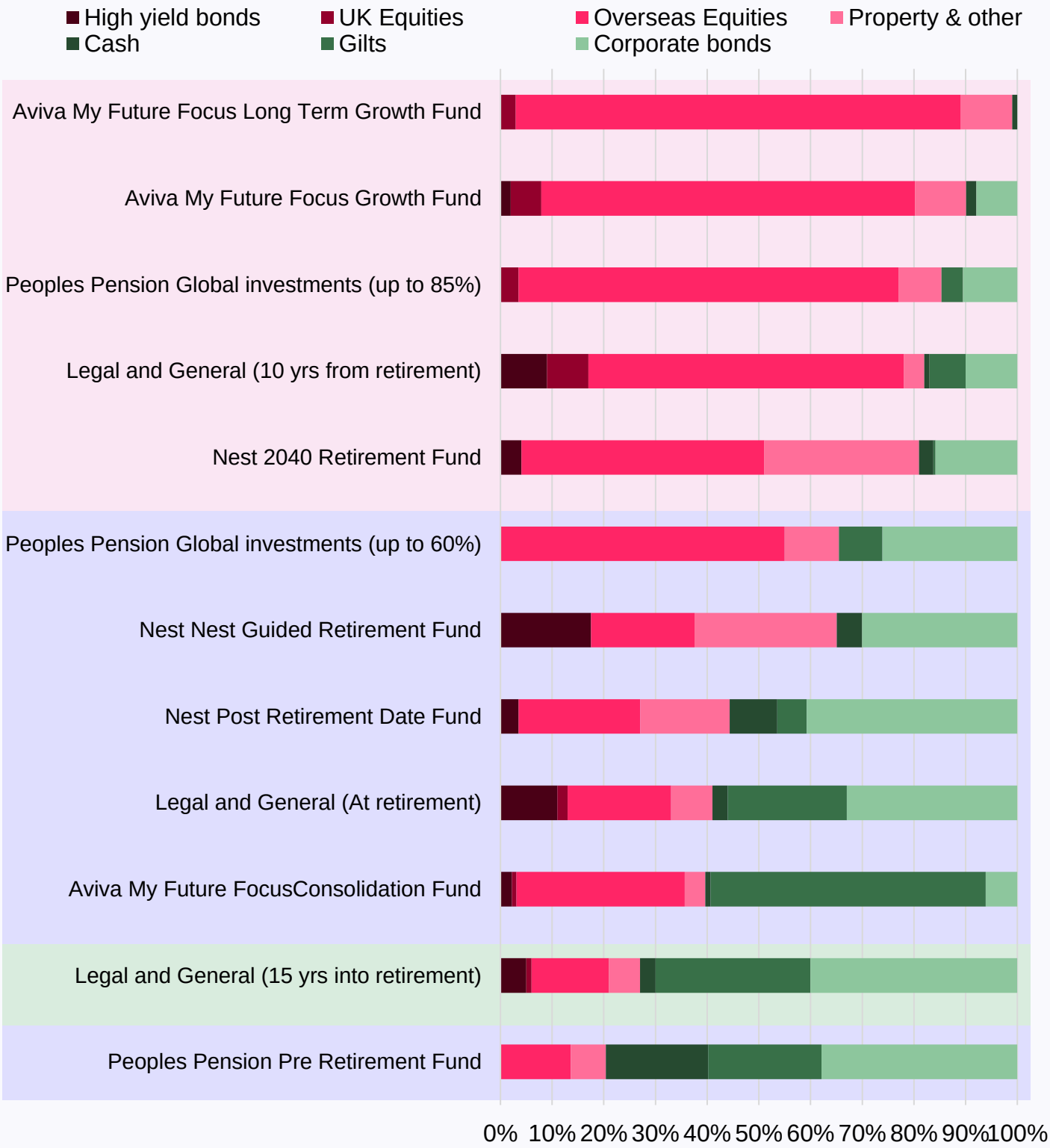
E.4 Figure 23 below shows various default DC asset allocations, with the higher risk assets as shades of red and lower risk assets as shades of green. DC investment strategies typically have different portfolios for members at different stages of their retirement journey, generally with high risk for more than 10 years before retirement, with risk then tapering down to a lower risk strategy into retirement. Note that it is increasingly common for DC members to keep assets invested for some years into their retirement before either buying an annuity or withdrawing their DC savings as cash.

E.5 The following shading of the fund labels indicate the age for which it is a default fund for:

- funds that are typically for members 10+ years before retirement (30+ years period)
- at retirement funds (20-30 year period)
- targeting those into their retirement (20 year and less period)

[25] https://go-group.co.uk/dc-master-trust-league-table-2024-h1/

Figure 23: Higher risk vs lower risk asset class split



Sources

Trust	Fund	Further description
NEST	NGRF (Nest Guided Retirement Fund)	For members between age 60 and 70 with £10k or more in their pot
	PRDF (Post Retirement Date Fund)	For members with pots under £10k when their Nest Retirement Date Fund matures and not withdrawing their savings
	2040 Retirement Fund	For members with a targeted retirement date of 2040
The People's Pension	Pre Retirement Fund	'Medium/low risk' portfolio
	Global Investments (Up to 60%)	'Medium risk' portfolio. Their 'cautious' profile would invest in this fund, moving to pre-retirement fund as approaching retirement age.
	Global Investments (Up to 85%)	'High/medium risk' portfolio. Their 'balanced' profile would invest in this fund, moving to pre-retirement fund as approaching retirement age.
Aviva	My Future Focus Long Term Growth Fund	For members 15 years or more to retirement
	My Future Focus Growth Fund	For members closer to retirement (up to 10 years before retirement)
	My Future Focus Consolidation Fund	For members in retirement
L&G	10+ years from retirement	For members 10 years or more from retirement
	At retirement	For members at the point of retiring
	15+ years into retirement	For members 15 years or more into retirement