ALL CHANGE PLEASE – THE DISCOUNT RATE CONSULTATION

The moment we've all been waiting for finally arrived today with the Ministry of Justice's announcement that the Lord Chancellor and Justice Secretary will today lay draft legislation before Parliament to change the way in which the personal injury discount rate is set, followed shortly thereafter by a 59 page paper entitled 'The Personal Injury Discount Rate: How it should be set in future' and a 23 page paper with the same title but containing the draft legislation. The aim of this piece is to provide the busy reader with a helpful summary of the contents of those papers.

'The Personal Injury Discount Rate: How it should be set in future'

The three core issues examined by the consultation paper were:

1. What principles should guide how the rate is set?
2. How often should the rate be set?
3. Who should set the discount rate?

It also addressed an ancillary issue of whether periodical payment orders are being used sufficiently.

The bulk of the paper deals with the results of the consultation and itemises the way in which the 135 respondents (ranging from insurers and lawyers to actuaries and forensic accountants) answered the 36 questions in the consultation.

The conclusion begins at page 44. Presumably with half an eye on a further challenge by way of judicial review, the paper makes clear that the Government has carefully considered all the replies to the consultation and taken into account the results of research carried out by the Government Actuary's Department[1] and the British Institute of International and Comparative Law[2], as well as responses to questionnaires from the Wealth Management Association, the Personal Finance Society and the Association of Professional Financial Advisors about the investments that personal injury claimants would be advised to make.

It answers the three questions as follows:

1. What principles should guide how the discount rate is set?

   Claimants should be taken to be more risk averse than ordinary prudent investors such that they would invest in **low risk** but not, as currently assumed, very low risk investments such as Index Linked Gilts (ILGs) alone.

   The Government believes the current assumption that claimants will only invest in very low risk investments is unrealistic and may produce significantly larger awards than provide 100% compensation.

2. How often should the discount rate be set?

---

[1] Analysing the impact of setting the discount rate using different risk appetites and investment strategies, including simulated modelling of various scenarios.

[2] Examining the issues of the discount rate applying to quantum in PI cases from a comparative law perspective, focusing on Australia, Canada, France, Germany, Hong Kong, Ireland, Spain and South Africa. This noted a broad range of rates from 6% in the Australian State of Victoria to 3.5% in Spain. No other jurisdiction had a negative discount rate.

There will be a requirement for a review at least every **3** years.

3. Who should set the discount rate?

The Government recognises there is a need for a fairer and better framework for the setting of the discount rate and intends to make the following changes to the law:

a. The rate will be set by reference to expected rates of return on a low risk diversified portfolio of investments; and in assessing those rates the actual investment practices of claimants and the investments available to them should be considered.

b. The principles for setting the discount rate should be set out in statute.

c. The rate is initially to be reviewed promptly after the legislation comes into force and, thereafter, at least every 3 years, with that period being re-set when the rate is changed. Reviews will be completed within 180 days of starting.

d. The **rate is to be set by the Lord Chancellor with advice from an independent expert panel**, although the initial review will be by the Lord Chancellor with advice from the Government Actuary. HM Treasury will be a statutory consultee for all reviews. The expert panel will be chaired by the Government Actuary and include four other members having experience as an actuary, an investment manager and an economist, and experience in consumer investment affairs.

e. It will continue to be possible to set different rates for different types of cases, including by reference to the length of the award.

f. No changes are proposed to the law on PPOs.

Under the new law the discount rate will reflect the rate of return to be expected of a low risk diversified portfolio but it will be for the Lord Chancellor to apply the legal principles set out in the legislation and on that basis to decide where in the range of low risk the rate should be set.

The key legal principle will be:

> "*that the rate should be the rate that, in the reasonable opinion of the Lord Chancellor, a properly advised recipient of a lump sum of damages for future financial loss could be expected to achieve if he or she invested the lump sum in a diversified low risk portfolio with the aim of securing that (a) the lump sum and the income from it would meet the losses and costs for which they are awarded when [they] are expected to fall; and (b) the relevant damages would be exhausted at the end of the period for which they are awarded.*"

As part of the exercise the Lord Chancellor will therefore be required to consider the investments available and actual investments made by claimants; and must make such allowance for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate.

Having set out the Government's intention, the paper makes clear that the Government will be publishing draft clauses to embody these conclusions. The draft clauses will be laid before Parliament today for pre-legislative scrutiny and the intention is to "*introduce legislation to enact these proposed changes to the law into Parliament as soon as parliamentary time permits*". Once in place, the changes will be brought into force in the usual way by the Lord Chancellor who will also initiate the last review of the rate under the current law within 90 days. That review will apparently be completed within 180 days and a new rate set, if the Lord Chancellor considers a change is appropriate.

The draft legislation

The foreword by the Lord Chancellor invites comments on the draft discount rate legislation which has been prepared to implement the Government's proposals as set out above but also makes clear that the Government "*intends to legislate promptly to make sure that the way the rate is set is put on the best possible footing at the earliest practicable date so that we have a better and fairer system for claimants, defendants and society as a whole.*" The latter point is developed further at paragraph 17 of the 'Summary of proposals' which says that "*Claimants will continue to receive full and fair compensation, but by aligning the discount rate to how claimants invest in practice defendants and their insurers will no longer pay greater than 100% compensation because of the application of an* ***artificially low discount rate***.[3]"

It is also envisaged that the more frequent reviews should avoid sizeable shifts in the rate as the rate will be aligned with returns from investments more often and thereby avoid potential 'shock' to the financial system occasioned by substantial changes of rate for which the market is unprepared.

The draft legislation is drawn so as to enact amendments to the Damages Act 1996, albeit the legislation relates only to England and Wales. It carries forward the Lord Chancellor's existing delegated powers to make secondary legislation specifying the discount rate in a statutory instrument and the requirement on the court to take the rate prescribed by the Lord Chancellor into account subject to and in accordance with any rules of court made for this purpose. No transitional arrangements are proposed and any change in the rate made under the new provisions will not affect awards of damages, but will from the date the change comes into force be taken into account by the courts in assessing the rate of return to be expected from the sum awarded in place of the previously applicable rate.

Useful comments are made about the impact of the proposed legislation at paragraphs 24 and following of the paper, in particular paragraph 27 which says:

> "*broadly speaking, based on the evidence currently available and without fettering the exercise of the Lord Chancellor's discretion in the future, the Government would expect that if a single rate were set today under the new approach the real rate might fall within the range of 0% to 1%.*"

This estimate is said to be based on the expected returns over longer award periods as set out in the Government Actuary's Department report which the MoJ commissioned, and also reflects the new assumption that claimants are to be assumed to be prepared to take a low level of investment risk.

The two papers can be accessed here:

[3] (**bold** emphasis added)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642812/discount-rate-response-consultation-print.pdf

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642706/personal-injury-discount-rate-command-paper-web.pdf

Sadie Crapper