

BRIEFING: THE PERSONAL INJURY DISCOUNT RATE



Association of Personal Injury Lawyers

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The Association of Personal Injury Lawyers (APIL) is a not-for-profit organisation which has worked for more than 25 years to help injured people gain the access to justice they need, and to which they are entitled. We have around 3,000 members who are committed to supporting the association's aims, and all are signed up to APIL's code of conduct and consumer charter. Membership comprises mostly solicitors, along with barristers, legal executives, paralegals and some academics.

Purpose of the personal injury discount rate, and how it works

The purpose of the discount rate (often incorrectly referred to as the 'Ogden rate') is to ensure that compensation does what it is required to do, by law: return the injured person to the position he would have been in, if it were not for the injury. No more, no less. This has been the basic tenet of the law since 1880.

The discount rate only applies to people who will have to cope with substantial financial losses in their futures: loss of earnings, for example, and the cost of round-the-clock medical care, as well as social care and support. They may need professional help washing, dressing, getting up and about, getting proper exercise. They may need help with social activities or may need to have their meals made. This is in addition to the need for specialist equipment to help them manage their disabilities. It is important to recognise that the people who are affected are those who have sustained catastrophic, life-changing injuries at the hands of other people – and that those responsible have been proven to be negligent. If the injured person is given a lump sum payment, he is expected to invest that sum in low or no-risk investments to ensure it lasts for the rest of his life. The lump sum compensation is reduced ('discounted') to reflect the rate of return on such investments, to ensure the injured person does not make a profit from his compensation.

A discount rate of 2.5 per cent was set in 2001. The economy changed dramatically in the intervening 16 years but there was no change in the discount rate until March this year, when the rate was corrected to minus 0.75 per cent. This change was long overdue, as deductions from compensation had been applied at a rate which was too high, forcing people either to take greater risks with their investments, or fall back on the State for support when the money ran out.

It is a cold, dispassionate way of ensuring people with life-changing injuries do not receive too much. It takes no account of the utter devastation of shattered lives, of pain, of suffering, of ruined relationships and family lives which will never be the same again.

The role of insurance

The basic principle of insurance is to spread risk among a large group of people. Whenever a loss occurs, it is compensated from the fund. Provision of compensation, when an insured person has injured someone else through his own negligence, is the purpose of insurance.

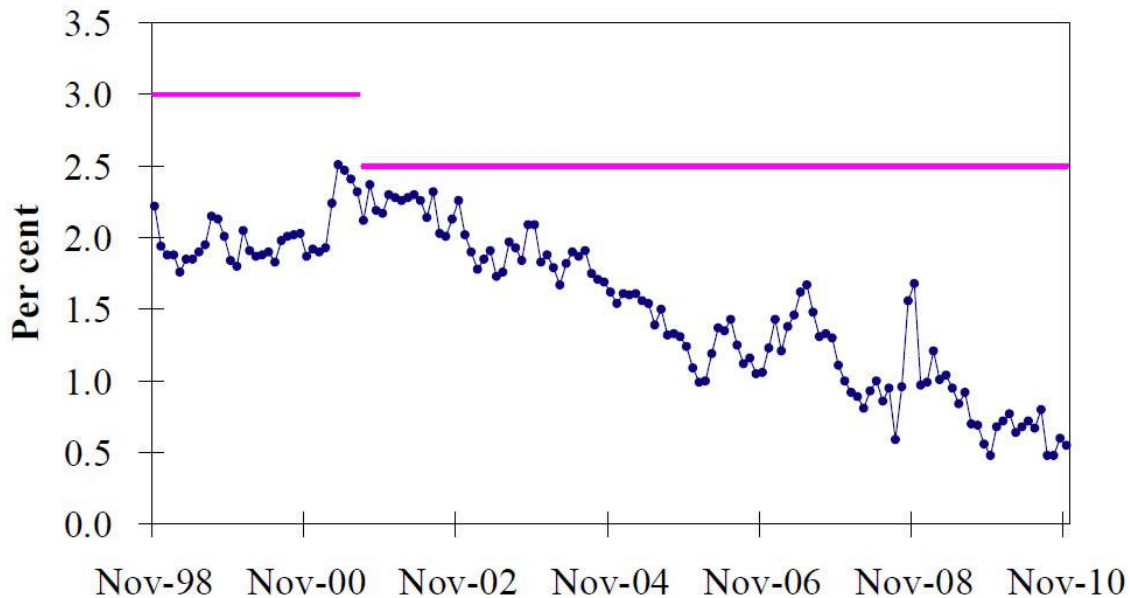
The insurance industry has been vociferous in its condemnation of the change to the discount rate, suggesting that the correction was a complete surprise and that the industry cannot accommodate the increase. It is therefore argued by the insurance industry that insurance premiums must be increased and that injured people are somehow responsible for these higher premiums.

These arguments are disingenuous.

APIL first began judicial review proceedings against the Lord Chancellor in 2011, after an ongoing failure to review the discount rate. A change should have been anticipated by the insurance industry, and planned for, from that point. The fact that the rate fell so dramatically demonstrates that change was long overdue.

The discount rate is based on yield from index linked Government gilts (ILGS). According to a group of academics writing in the Law Society Gazette in 2010¹:

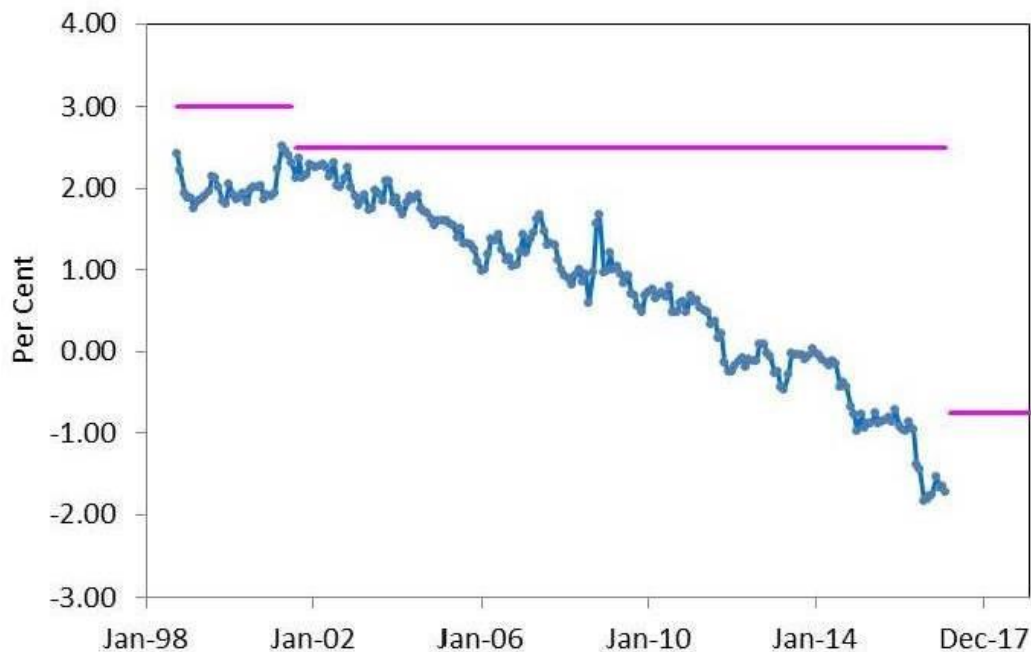
For the past 10 years, ILGS yields have been sliding down and significantly below [the discount rate]. The rate recently dipped below the 0.5% mark and the average yield for the 36 months leading up to November 2010 was, for example, only 0.84%. This is demonstrated in the graph below.



Gross redemption yields on Index-Linked Government Securities (over 5 years, with inflation of 5%) and the prescribed discount rates (pink lines) from November 1998 to November 2010. The primary data were kindly provided by the FTSE Group.

¹ *Time to review the discount rate in personal injury claims*, by Professor Johnny Li, Professor Wai-Sum Chan and Assoc. Professor Felix Chan. *Law Society Gazette*, 6 December 2010: <https://www.lawgazette.co.uk/analysis/time-to-review-the-discount-rate-in-personal-injury-claims/58382.article>

This graph has since been updated by Professor Chan, below:



Gross redemption yields on Index-Linked Government Securities (over 5 years, with inflation of 5%) and the prescribed discount rates (pink lines) from November 1998 to February 2017. The primary data were kindly provided by the FTSE Group.

It is clear that injured people have been significantly under-compensated while insurers have quietly reaped the financial benefits of the 2.5 per cent discount rate.

In the meantime, the change to the discount rate is barely making a dent in the profits of many insurers. By way of example: Admiral stated in its 2016 results that 'motor profit after the impact of the Ogden change is £336 million².

Hastings said 'the reduction in the Ogden rate is not expected to have a material impact on the group's financial outlook for 2017'³.

² Admiral Group plc 2016 full year results, March 2017: <https://admiralgroup.co.uk/investor-relations/results-and-presentations>

³ Hastings full year 2016 results, March 2017: <https://www.hastingsplc.com/investors/results-centre>

Announcing its 2016 results, Direct Line said it ‘does not expect any material residual impact on 2017 profit as a result of adopting the reduction in the Ogden discount rate’⁴.

Insurance costs what the insurance industry says it costs. Many insurers will choose to prioritise the profit of their shareholders and pass on the cost of the corrected discount rate to premium payers rather than their shareholders. These are the insurers’ own business decisions, and are not the fault of severely injured people.

The attitude of injured people towards investment

Injured people are not stockbrokers. The first thought of someone who receives compensation following a catastrophic, life-changing injury is not “how can I make the most of this fantastic windfall?”. It is instead “how can I eke out my compensation payment to make sure it lasts long enough to look after me and my family for the rest of my life?” Or “will my compensation payment keep pace with inflation in the long term?”

It is the experience of our members that seriously injured people invest their compensation in a range of low, or risk-free, investments, as envisaged by the House of Lords in the case of *Wells v Wells*⁵ in 1998. Until the rate was changed some people were under pressure to make more risky investments because of concerns about how they were going to make ends meet under a discount rate which was austere and out of date. They were forced into this position by the prospect of hardship for themselves and their families.

It is, surely, the duty of society to ensure that vulnerable people are treated fairly, according to their needs. In such a society, people whose lives have been shattered by negligence, should never be put into the position of having to take chances with their compensation on a volatile stock market.

⁴ Direct Line full year 2016 results, March 2017: <http://www.directlinegroup.com/investors/results-and-presentations/2017.aspx>

⁵ [1999] 1 AC 345

Someone who has been through probably the worst thing ever to happen to him should be allowed to be a risk-averse, safe investor. The person whose life has been shattered because someone else was negligent should not have to worry about whether his funds will run out before he dies, forcing him to rely on the State for his care.

The person responsible for the injury should be held accountable and, through his insurance company which has received premium payments for just this eventuality, he should put right the wrong he has caused, as much as is possible in the most difficult of circumstances.

Periodical payment orders

A periodical payment order (PPO) is a continuing series of index-linked, regular payments which will be made to the injured person for the rest of his life, providing him with a reliable, regular income. This is extremely important to many injured people, and early indications are that insurers have been more willing to offer compensation in this form since the discount rate was reduced. This is very welcome.

But PPOs are very rarely made in isolation. When a PPO is considered appropriate for an injured person, a lump sum will almost always still be needed to pay for immediate, often high-cost needs. This may not only mean accommodation or transport needs, but also equipment such as hoists, wheelchairs and prosthetic limbs. A PPO could never, therefore, replace a lump sum payment: rather, the two forms of payment complement each other.

For example, one of our members acts for a seriously injured, nine-year-old child who is expected to live to the age of 70. The child's parents are in their 40s. Their priorities are to provide appropriate accommodation for their child but also to ensure the child will be cared for, for the rest of his life, and particularly after the parents' death.

100 per cent compensation

We welcome the commitment to full compensation in the Government's consultation on the discount rate⁶. This commitment was reiterated by treasury minister Stephen Barclay during a speech at an Association of British Insurers conference in June this year. This was also very welcome, and it is important that this commitment is not eroded by concern for business.

As Lord Scarman said in *Lim Poh Choo v Islington Area Health Authority*⁷ "There is no room here for considering the consequences of a high award upon the wrongdoer or those who finance him. And, if there were room for any such consideration, upon what principle, or by what criterion, is the judge to determine the extent to which he is to diminish upon this ground the compensation payable?"

Page 10 of the Government's consultation document says: 'in setting the rate the Lord Chancellor and her counterparts in Scotland cannot be influenced by the effect of the change in the rate on defendants. To do so would be to address the wrong question.

The rate is set to ascertain what claimants are expected to need to meet their losses given present understanding of future investment returns. In its present form, therefore, assuming that the rate itself is "correct", the rate protects both claimants and defendants equally.'

Injured people pay their taxes. Most will pay insurance premiums, at least until the time of their injuries. They should be fully and fairly compensated by those who are responsible for their injuries, according to their needs.

The distress of their injuries and the impact of those injuries on their lives and their families should not be compounded by constant worry about how to make ends meet. Nor should the State have to pay for their future care.

⁶ The Personal Injury Discount Rate: how it should be set in the future, Ministry of Justice, March 2017

⁷ *Lim Poh Choo v Islington Area Health Authority* [1980] Ac 174

Conclusion

The way to ensure people with life-changing injuries receive the compensation they desperately need is to retain the current formula for calculating the discount rate, for the reasons set out above. The way to cushion the insurance industry, which ultimately pays the compensation, from sudden and, possibly dramatic, changes in the rate is to ensure it is reviewed on a regular basis.

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