

HOUSE OF COMMONS JUSTICE SELECT COMMITTEE

Inquiry: Draft personal injury discount rate legislation inquiry



Written evidence from the Association of Personal Injury Lawyers

October 2017

The Association of Personal Injury Lawyers (APIL) is a not-for-profit organisation which has worked for almost 30 years to help injured people gain the access to justice they need and to which they are entitled. We have around 3,300 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.

Any enquiries in respect of this response should be addressed, in the first instance, to:

Lorraine Gwinnutt

Head of Public Affairs

APIL

3 Alder Court, Rennie Hogg Road, Nottingham NG2 1RX

Tel: 0115 943 5404

Email: lorraine.gwinnutt@apil.org.uk

Executive Summary

- The proposed new mechanism for calculating the discount rate will not deliver the Government's objective of fairness to all.
- The discount rate must be based on 'very low risk' investments rather than 'low' risk investments.
- Injured people who, under the old discount rate of 2.5 per cent, relied on riskier investments were forced to do so to make ends meet. Many others were forced to rely on family or the State for help when their compensation ran out.
- The model portfolio relied on by the Government for calculating the new discount rate relies heavily on hedge funds and equities and cannot, therefore, be considered 'low risk'.
- The Government Actuary's Department analysis shows a significant number of injured people would not receive 100 per cent compensation under the model favoured by the Government.
- The Government has said in an earlier consultation that the Lord Chancellor 'cannot be influenced by the effect of the change in the rate on defendants. To do so would be to address the wrong question.
- There is no correlation between the cost to insurers of bodily injury claims and the price of motor insurance premiums: there will be no reduction in premiums as a result of the proposed change.
- The use of an expert panel to advise the Lord Chancellor, and a review of the discount rate every three years is welcomed.

Objective of legislation

Q: The Government's stated objective is to "reflect actual claimant investment behaviour and ensure claimants are compensated in full neither more or less".

Does the text of the draft legislation achieve this objective, and could it be better achieved by other legislative or non-legislative means?

1. Discussions about the discount rate can be summarised in two key points:
 - the attitude of injured people to investment, and how they have invested historically
 - the need for fairness

2. The draft legislation does not reflect actual claimant behaviour or the attitude of injured people to the investment of their compensation. Claimants are usually advised to spread their compensation across a basket of very low risk investments. While the discount rate was artificially high at 2.5 per cent, however, claimants were often forced into the invidious position of having either to take chances with their compensation by putting it into higher risk investments, or struggling to make ends meet. This is the reason APIL began judicial review proceedings in the first place.

3. The scale of the challenge faced by injured people under the old discount rate is illustrated in an article by financial adviser Edward Tomlinson in the *Journal of Personal Injury Law*¹. Mr Tomlinson states that, under the 2.5 per cent discount rate, taking into account inflation, charges and tax, an injured person would have had to have made a profit on his investment of between 6.9 per cent and 12.5 per cent a year just to ensure his compensation payment reflected what was originally awarded by the court. It is impossible to envisage how anyone could have made that level of profit on investment during the straitened economic circumstances of recent years.

4. And in all those years, when injured people were forced either to go without or gamble their compensation in risky investments to try to make ends meet, insurers quietly reaped the financial benefits of a discount rate which was out of kilter with the economic environment.

¹ The Discount Rate, What's Next? By Edward Tomlinson, 2017 JPIL Issue 2, page 108

5. It is often suggested that injured people are happy to take risks with their compensation, which means that basing the discount rate on a 'very low' attitude to risk results in many people being over-compensated. This argument is utterly disingenuous. Injured people are not stockbrokers, or even normal investors. 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?"

6. The basis of the Government's draft legislation is that claimants should invest in 'low risk', rather than 'very low risk' investments. It relies on analysis from the Government Actuary's Department (GAD) and, in particular, the outcome of an assumed investment strategy based on a portfolio of 'low risk' investments².

7. We understand from the Ministry of Justice that portfolio A (paragraph 4.8, page 12 of the analysis) will form the basis of the Government's thinking. We submit that an investment strategy which relies heavily on hedge funds and equities cannot possibly be considered 'low risk'. In fact, the Money Advice Service, set up by the Government, provides guidance on investment risk as follows:

Managing risk

One of the most important aspects of risk is the extent to which the value of your investments is likely to swing up and down.

This is called capital risk. Different asset classes have different levels of risk.

For example, cash (saving in things like savings accounts) has low capital risk.

² <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/gad-analysis.pdf> page 12

Ranked in order of increasing capital risk, the traditional asset classes generally come out like this:

- *Cash (lowest risk)*
- *Fixed-interest*
- *Property*
- *Shares (highest risk)*

If you want a low-risk portfolio, you should aim to hold a high proportion of your investments as cash and fixed-interest securities.

A higher risk portfolio will have a relatively high proportion in shares³.

7. The GAD analysis has identified that a significant number of claimants would not receive 100 per cent compensation under the favoured model:

- They would have a 30 per cent chance of being under-compensated by five per cent or more if the discount rate were set at +1 per cent
- They would have a 19 per cent chance of being under-compensated by five per cent or more if the discount rate were set at +0.5 per cent
- They would have an 11 per cent chance of being under-compensated by five per cent or more if the discount rate were set at 0 per cent.
- Even at the current discount rate of -0.75 per cent, claimants would have a four per cent chance of being under-compensation by five per cent or more, according to this model.

In its draft legislation document the Government says it '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%.⁴ This makes a complete mockery of the Government's repeated assertions that 'awards of damages should provide full compensation, neither more no less'⁵.

³ <https://www.moneyadvice.service.org.uk/en/articles/asset-classes-explained>

⁴ <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/personal-injury-discount-rate-command-paper-web.pdf>, page 11

⁵ Ibid, page 3

8. The only way for the Government to achieve its policy objective of ensuring catastrophically injured people receive 100 per cent compensation is for the Government to recognise that 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 injured person should be able to invest in genuinely very low risk investments.

Fairness of legislation

Q: Will the proposed legislation result in a fairer framework for (a) claimants, especially those for whom any risk would be ill-advised (b) defendants and (c) wider society? Is the move from ‘very low risk’ to ‘low risk’ appropriate, and are these terms clear enough?

9. For the reasons outlined above, the move from ‘very low risk’ to ‘low risk’ is inherently unfair for claimants and, frankly, it is fairness to injured people which has to take precedence here. Nothing has changed since Lord Scarman said in *Lim Poh Choo v Islington Area Health Authority*⁶: “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?”

10. In its response to the consultation *The Personal Injury Discount Rate: How it should be Set in Future*⁷, the Government 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.’

⁶ *Lim Poh Choo v Islington Area Health Authority* [1980] Ac 174

⁷ <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-print.pdf>, page 10

11. Calculation of personal injury compensation is based on the needs of people who have been injured through no fault of their own. In the kind of catastrophic injuries which trigger the use of the discount rate, injured people can face substantial financial losses: loss of earnings, for example, the cost of round-the-clock medical care, and 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.

Q: Should the way personal injury claimants generally choose to invest lump sum damages influence how damages are calculated for all such claimants?

12. Injured people need a fair system which recognises the fact that people with life-changing injuries should not have to gamble with the compensation which is carefully calculated to last for the rest of their lives. The fact that many people are so risk averse that their compensation investments may not even keep up with inflation is often overlooked.

13. The Financial Conduct Authority (FCA) reports in its business plan, for example, that 'there remains a significant proportion of consumers with low levels of financial capability. Consumer behaviours and biases will always exist in financial decision making and are often exacerbated by low financial capability.'⁸ In our view, this contributes to the risk that the seriously injured claimant or the claimant's family (where the claimant lacks capacity, for example) take the view that the most risk averse action they can take is to make a cash investment with their bank or invest in the only other truly risk free investment (other than ILGS): National Savings and Investment bonds.

⁸ <https://www.fca.org.uk/publication/business-plans/business-plan-2017-18.pdf>

14. Damages must be calculated on the assumption of very low risk investments and the system should be reviewed on a regular basis. This is an issue of need: the actual concrete needs of people who have been injured through negligence must be met in a fair and just, 21st century, society.

Impact of legislation

Q: How robust is the Government’s analysis of the proposal and of its impact on (i) claimants (ii) insurance companies and (iii) the NHS? (Impact assessment).

Who will be the main losers from the proposal and how much will they lose by?

15. We have fundamental concerns about some of the assumptions made in the impact assessment (IA). The IA sets out the Government’s policy objective of reflecting ‘actual claimant investment behaviour’ without making any attempt seriously to take into consideration the reason why some injured people are forced to make higher risk investments to make ends meet.

16. According to paragraph 39 of the IA: “Although the consultations (sic) responses suggested claimants are advised to and are investing in assets with a higher expected return than that of a portfolio of 100% ILGS, **it is not entirely clear at present what return a claimant should be expected to pursue. This is because the PIDR and a claimant’s investment strategy may influence one another, i.e. the size of a claimant’s lump sum (determined by the PIDR) may affect the investment strategy pursued.** Nevertheless, even after accounting for this inter-dependency, it is likely that, under this option, the PIDR will be set with reference to an investment strategy with a higher expected return than assumed under the current framework.”⁹ (our emphasis added).

⁹ <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-impact-assessment.pdf>

17. Here the Government clearly recognises that the discount rate can, in itself, affect an injured person's attitude to risk and yet chooses an option which forces the claimant into a position of having to make riskier investments than at present. The fact that such investments can just as easily result in losses as well as gains appears to be of little concern. The option which would offer greatest fairness and predictability for all parties concerned would be to maintain a discount rate based on 'very low risk', as identified by the court in *Wells v Wells*¹⁰.

18. In his judgment in the case, Lord Hope of Craighead said:

“...the plaintiff who is receiving the amount of his future loss in the form of a lump sum is not an ordinary investor. The amount awarded under each head of his claim is calculated on the assumption that this part of his loss will have to be met entirely out of the relevant portion of the lump sum. So in his case the only form of investment which could be described as a prudent investment is one which will as nearly as possible guarantee the availability of the money as and when it is required. He cannot afford to wait until the market moves in his favour, or to sustain the loss of capital which would result if he was forced to sell at a price which did not match the inflation rate.”

19. The IA also erroneously and naively assumes that 'in an open and competitive market insurance companies will pass on any savings derived from a higher PIDR rate onto consumers in the form of lower insurance premiums. There will be substantial savings to public bodies such as NHS Resolution.'¹¹ The reasons why it is incorrect to assume savings will result in lower insurance premiums is dealt with in our answer to the question below. In terms of NHS Resolution, however, the fact is that NHS Resolution only has to pay compensation when the NHS has injured a patient through proven negligence. The choice is whether the State (usually the NHS) pays what is awarded to an injured patient as a result of its own negligence, or whether it picks up the tab for the negligence of everyone else who has caused needless injury because, under the Government's proposal, the compensation which they were liable to pay no longer meets the needs of the people they have injured.

¹⁰ [2008] EWHC 919, page 29

¹¹ *Ibid* page 2

20. The IA bases much of its analysis on the ‘evidence gathered during the recent consultation’. In effect, ‘51 responses (mainly from insurers and their advisors) suggested that claimants be assumed to be ‘low risk’ investors (ie between ‘very low risk’ and ‘ordinary prudent’ investors) while 41 responses favoured retaining the *Wells v Wells* assumption of ‘very low risk’.¹² The clear implication is that if another 12 responses had favoured the *Wells v Wells* approach, the Government may have been persuaded in a different direction. It seems that decisions about fairness for people with life-changing injuries rest not on strength of argument, but on simple mathematics.

Q: How likely is it that changing the methodology for calculating the discount rate will result in a reduction of insurance premiums? Is the Government right to assume that insurance companies will pass on savings?

21. The Government is completely wrong to assume a change in methodology will result in lower insurance premiums. Fundamental reforms to the legal process and the costs of that process have been ongoing over the past four years. Every reform has been accompanied by a promise from the insurance industry that savings will be passed on in the form of lower premiums. These promises have never been kept.

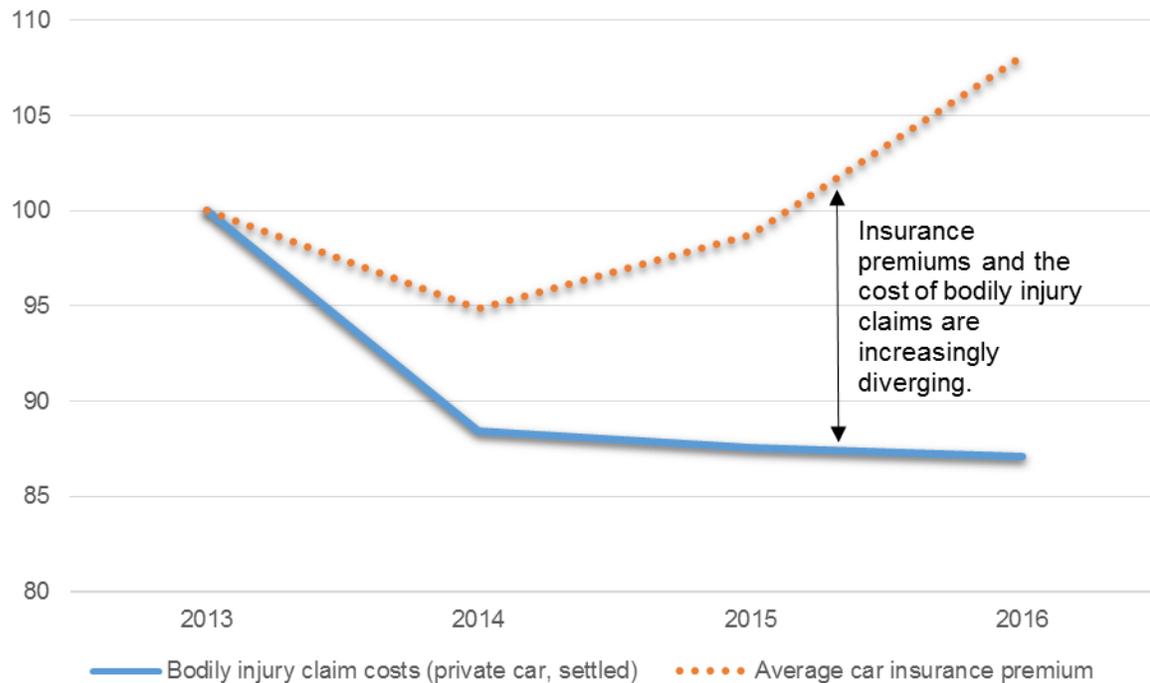
22. Between 2013 and 2016 the cost to motor insurers of settled bodily injury claims fell by 13 per cent, according to the Association of British Insurers¹³. Over the same period, the average motor premium increased by eight per cent, according to the same source¹⁴. Sustained falls in the cost of bodily injury claims did not result in similar reductions in car insurance premiums, as the chart below illustrates.

¹² Ibid, page 6, paragraph 13

¹³ Association of British Insurers, *2017 Q2 Motor Insurance Claims*, August 2017, accessed at <https://www.abi.org.uk/data-and-resources/industry-data/industry-data-and-subscriptions/>

¹⁴ Association of British Insurers, *Motor Insurance Premiums 2017 Q2*, July 2017, accessed at <https://www.abi.org.uk/data-and-resources/industry-data/industry-data-and-subscriptions/>

Cost of motor related bodily injury claims, average motor insurance premium (base=2013)



Sources: Gross bodily injury claims paid (private car, settled) - Association of British Insurers; average motor premium – Association of British Insurers¹⁵

There is no positive correlation between bodily injury claim costs and insurance premiums and, therefore, no basis for the argument that an increase in the discount rate will result in lower car insurance premiums.

Process proposed by legislation

**Q: Who should be on the expert panel, and who should make the final decision?
Are there any circumstances where the Lord Chancellor should not follow the advice of the independent expert panel?**

¹⁵ <https://www.abi.org.uk/data-and-resources/industry-data/industry-data-and-subscriptions/>

23. We are comfortable with the Government's proposal that the panel will be chaired by a Government actuary and include four people who have experience as an actuary, an investment manager, an economist and in consumer investment. We are concerned, however, that the language of the legislation allows too much discretion for the Lord Chancellor to disregard the advice of the panel. We have suggested amendments to the Ministry of Justice which ensure that the Lord Chancellor always takes account of the expert panel, and gives reasons for his decisions.

Q: Would it be better to review the rate more, or less, frequently than proposed (every three years)?

24. We are comfortable with the proposal that the rate should be reviewed every three years, but we are concerned that the expert panel will not be in place for the first review. The panel must be in place for this first review which, arguably, is the most important review for many years.

Q: Does the proposal allow different discount rates to be set for different types of loss? What would be the advantages and disadvantages of this approach?

25. The draft legislation provides for different rates of return for 'different classes of case'. We assume this to mean different heads of damage, rather than different categories of claim, and have suggested amended language to the Ministry of Justice to make this distinction clear.

26. It has always been possible to ask the court to use its discretion under the Damages Act to apply different rates: different rates for different heads of damage can be helpful in taking into account the fact that earnings usually rise faster than prices. NHS Resolution assumes, for example, that the differential between the retail price index (RPI) and ASHE 6115 (a wage inflation index which measures the rate of change in care workers' earnings) is one per cent.¹⁶ Care costs are a very large part of many large claims and so a failure to take this into account will be problematic for seriously injured claimants.

¹⁶ NHS Resolution Annual Report and Accounts 2016-17, page 144

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- ▶ 3 Alder Court, Rennie Hogg Road, Nottingham, NG2 1RX