

18 August 2020



RPI Consultation Team  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ

Dear Sir/Madam

### **Response: A Consultation on the Reform to Retail Prices Index Methodology**

APIL welcomes the opportunity to respond to HM Treasury's consultation on the reform to Retail Prices Index Methodology.

Most of the consultation is outside of our remit, but we are keen to respond to question five in particular, to highlight, as requested, other impacts which the proposed changes will have in areas or contracts where the RPI is used. Particularly the effects that the proposed changes may have on damages paid to injured people.

#### **Q5. What other impacts might the proposed changes to address the shortcomings of the RPI have in areas or contracts where the RPI is used?**

The proposed changes will have a significant effect upon people who, having been injured through no fault of their own, have been compensated with damages for their personal injuries as follows:

##### **a. Scotland: calculation of the discount rate**

The discount rate is the rate by which lump sums of damages are 'discounted' to make provision for the presumed rate of return which the injured person will achieve by investing their damages in a low risk manner over time. The discount rate usually comes into play in cases where the individual has been seriously injured and has damages which must be made to last for their lifetime to pay for the cost of their care.

The Damages (Investment Returns and Periodical Payments) (Scotland) Act 2019 provides that when calculating the discount rate in Scotland, allowance must be made by the rate-assessor for the impact of inflation on the value of the return on investment. The impact of inflation is to be allowed for by reference to the retail prices index within the meaning of section 833(2) of the Income and Corporation Taxes Act 1988, or some published information relating to costs, earnings or other monetary factors as is, for use instead of the retail prices index, prescribed in regulations made by the Scottish Ministers.

At present, the 2019 Act prescribes the use of the retail price index and there are no other regulations which would permit the use of alternative indices.

The proposed changes involve aligning RPI with a different measure of inflation – CPIH (Consumer Price Index including Owner Occupiers' Housing Costs). Since 2010, the annual

rate CPIH inflation has been, on average, one percentage point lower than RPI as currently calculated. As a result, these proposals are likely to result in a lower rate of RPI.

Inflation is essentially a “deduction” from the injured Pursuer’s rate of return. A lower deduction for inflation will result in a higher personal injury discount rate in Scotland which will, in turn, reduce the amount of damages paid to severely injured people.

This is set out in the two hypothetical scenarios below. The discount rate is higher in Scenario B due to the lower rate of RPI inflation.

**Scenario A (higher rate of RPI inflation)**

<i>Rate of return on investment</i>	3%
<i>Deduction for RPI inflation</i>	2%
<i>Deduction for taxation/ investment management charges</i>	1%
<i>Discount rate (return minus deductions)</i>	0%

**Scenario B (lower rate of RPI inflation)**

<i>Rate of return on investment:</i>	3%
<i>Deduction for RPI inflation:</i>	1%
<i>Deduction for taxation/ investment management charges:</i>	1%
<i>Discount rate (return minus deductions):</i>	1%

What is unclear is *how* much lower the rate of RPI will be over the longer-term as a result of the proposed changes.

What is clear is that the legislation which mandates how the discount rate is calculated in Scotland would also need to be amended to take any changes in the calculation of the RPI into account, should the proposed changes come into effect.

**b. Periodical Payment Orders (all UK jurisdictions)**

The Damages Act 1996 and the Damages (Investment Returns and Periodical Payments) (Scotland) Act 2019 permit the court in personal injury proceedings to make a periodical payments order (PPO), a lump sum award or a combination of the two. In claims involving more serious injuries where a claimant, or pursuer in Scotland, may have long term care or other future needs, the courts may decide that part of the settlement or award is should be paid on an annual basis, over an extended period of time. Often this is the best way to serve the long-term needs, interests and requirements of the injured person.

PPOs are indexed to take into account inflation: the cost of care is likely to rise as time goes by and annual payments must therefore also increase if the claimant/pursuer is to continue to be able to pay for care. The RPI is often the default measure in personal injury claims in the UK.

There has been case law in England and Wales (*Flora v Wakom (Heathrow) Ltd* [2006] EWCA Civ 1103 and subsequently *Thompstone v Tameside & Glossop Acute Services NHS Trust* [2008] EWCA Civ 5) which permit PPOs to depart from the RPI and to use alternative indices but there are still PPOs in operation in England and Wales, and certainly in Scotland where *Flora* and *Thompstone* are not binding authorities, where the payments are linked to the RPI and which would be adversely affected by the changes proposed in this consultation.

**Q6. Are there any other issues relevant to the proposal the Authority is minded to make of which the Authority or the Chancellor ought to be aware?**

Under the notional investment model used by Government Actuary's Department (GAD) to determine the discount rate in Scotland, as described above, the percentage of investments held in Index linked Gilts (Gilts) was ten per cent.

In the approach used in the setting of the discount rate in England and Wales, the 'central' portfolio modelled by GAD assumed that 30 per cent of the portfolio would be invested in Gilts, both nominal and index-linked. GAD did not disclose the proportion of the Gilts which were index-linked, but an overall allocation of around ten per cent would seem reasonable.

The proposed change would create a modest lowering of the discount rate, if the current model portfolios remained unchanged, when reassessed in four years' time. Consequential adjustments to the law relating to the discount rate and PPOs will be required in order to ensure that under-compensation does not occur.

Additionally, claimants who have already received their personal injury awards are also likely to hold a proportion of their investments in index-linked Gilts. If the total return achieved from index-linked Gilts falls as a result of the proposed change, then this will either create some under-compensation or force claimants to expose their capital to higher levels of investment risk (as no other investments currently provide a certain RPI-linked return).

It is worth noting that the RPI has always been an imperfect measure for inflation of personal injury damages, primarily because many of the largest aspects of damages are earnings related and others involve items, such as disability related aids and equipment have not been included in the RPI (or CPI) 'basket'. Claimants' legal representatives have resorted to seeking the court's approval to use alternative indices, such as ASHE (6115) as an alternative to the RPI to calculate the costs of future nursing care, for example.

Furthermore, the analysis which underlined the GAD's advice to the Lord Chancellor in England and Wales assumed that the costs faced by claimants ("damages inflation") inflate at CPI + 1%. In the GAD report (Martin Clarke, 25 June 2019)<sup>1</sup> this is made clear:

*"The results in this Chapter are based on the assumptions described further in Section III of this report ie a representative claimant investing over 43 years in the central low-risk portfolio that has a 42.5% allocation to growth assets, with damages inflating at CPI+1% pa and meeting annual tax and expenses of 0.75% of the fund value".<sup>2</sup>*

*"I therefore believe it reasonable to assume that claimant's damages inflate at CPI+1% pa and have accordingly included this in my analysis".<sup>3</sup>*

*"The PI discount rate should be used to determine lump sum damages to cover needs that are assumed to be subject to inflation of CPI+1% pa".<sup>4</sup>*

The GAD makes it clear that, when setting the personal injury discount rate, CPI alone is not enough. There is a need to add another 1% to CPI (i.e. CPI +1%) to accurately reflect how fast the costs faced by claimants (north and south of the border) increase.

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<sup>1</sup> *Setting the Personal Injury Discount Rate, Government Actuary's advice to the Lord Chancellor.* 25 June 2019, Martin Clarke, Government Actuary ('GAD Report')

<sup>2</sup> GAD report, para 2.4

<sup>3</sup> GAD Report, para 4.23

<sup>4</sup> Summary of report to Lord Chancellor, GAD Report, page 2

For all the reasons set out above, we urge caution and a consideration of the impact that the proposed changes will have upon personal injury claimants/pursuers.

We hope that our comments prove useful to you. If you have any comments on our response, please contact me by email [helen.blundell@apil.org.uk](mailto:helen.blundell@apil.org.uk) in the first instance.

### **About APIL**

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

Yours faithfully

A handwritten signature in dark ink that reads "Helen Blundell". The signature is written in a cursive, flowing style.

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