Ministry of Justice

Personal Injury Discount Rate

Exploring the option of a dual/multiple rate

Call for Evidence

April 2023

Introduction

The purpose of the personal injury discount rate (PIDR) is to ensure that compensation does what it is required to do by law: return the injured person to the position that they would have been in, but for the wrong committed against them (Lord Blackburn in *Livingstone v Rawyards Coal*, 1880). We welcome the Government's commitment to full compensation in the call for evidence. When the Government looked at the rate in 2017[1] it said that "in setting the rate the Lord Chancellor and her counter parts cannot be influenced by the effect of the change in rates on defendants"[2]. We would hope that the same reasoning is applied this time.

The rate at which the PIDR is set has the most significant impact on injured 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. Setting the PIDR too high results in under compensation, with people running out of money for essential care. They may need significant professional help as well as the need for specialist equipment to help them manage their disabilities. Any change to the PIDR can have a significant impact on an injured person. It is an imperfect way of ensuring people with life-changing injuries do not receive too much compensation. 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. Personal injury awards are compensation, they are not a windfall. The greater the levels of compensation the more catastrophic the injuries sustained, and the greater impact the negligence will have had on the individual. These seriously injured individuals will be the most reliant on their compensation. It will be fundamental to meeting their disability needs, they will also be reliant on specialist legal and investment advice.

We are concerned that, whilst the current rate is not perfect (it under compensates one third of claimants[3]) a dual or multiple rate will be no better. There will still be significant groups of claimants that will be worse off under the reforms.

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[1] The Personal Injury Discount Rate: how it should be set in the future, Ministry of Justice, March 2017
[2] Ibid page 10
[3] The move to a risk-based discount rate in 2019 was a significant change to the way in which the discount rate was calculated. Even with the Lord Chancellor's 0.5% adjustment to reduce the projected level of under compensation, one third of claimants were expected to be unable to 100% meet their financial losses. See statement by the Rt Hon David Gauke MP, Lord Chancellor, 15 July 2019

In addition to the impact on those individuals that have been injured, the a dual/multiple rate would create significant additional complexities in the valuation and presentation of these claims. The considerable additional work, associated cost, as well as an increased likelihood of errors all need to be considered. The work and cost involved would increase significantly, lawyers would be required to quantify a dual or multiple rate as each item of claim would need to be calculated based on each different discount rate. For example, a person who is paraplegic would have a significant schedule of loss which includes future expenses needed in the medium term and some in the longer term. Some items would need to be bought every year, and others at longer intervals, such as five or ten years. Currently catastrophic injury claim schedules are frequently 50 to 100 pages long with hundreds of individual calculations, so changing the discount model to a dual or multiple rate would significantly increase the complexity of these calculations leading to the risk of error.

APIL recommends that more should be done to increase the use of periodical payment orders (PPO) which ensure injured people have a regular income. PPOs meet the mischief created by the risk of under and over compensation yet remain a vehicle which is very much underused. The benefits of PPOs for an individual can be substantial. They provide regular payments to enable those who are seriously injured to meet their needs, notably in relation to care. They have a significant advantage over lump sums calculated using a discount rate in that they remove from the claimant the significant risks posed by longevity, inflation and tax. We suggest that it is far more important for the Government to take steps to encourage the use of PPOs rather than adopt a dual or multiple PIDR.

It is also crucial that the assumptions made in 2019 on tax and fees are reviewed as part of this work, if the government is committed to the principle of full and fair compensation, as stated in the call for evidence[4]. It is vital that these underlying assumptions are correct in order to ensure that the discount rate is set at the right level to avoid under compensation. Tax changes are planned for April 2023 and further reductions are planned thereafter (see Appendix A- Further detail regarding tax and feesAppendix A- Further detail regarding tax and fees). These will affect tax allowances, impacting on the assumptions that were made in 2019. The illustration in appendix A show that based on the upcoming changes to the tax allowances, a basic rate income tax paying claimant will be paying a greater level of tax in future years. In 2023/24 their tax liability would increase by 18%, and in 2024/25 their tax liability would increase by 27% compared to the current 2022/23 tax year.

In relation to fees, the Civil Liability Act 2018 allows for proper financial advice. However, the current assumptions, in the Government Actuary Report 2019[5] are in our view wrong. The Government Actuary Department (GAD considered different annual investment management costs ranging from 0.25 per cent to 0.5 per cent).[6] This is based on the client investing statically in low-cost passive funds and includes any VAT payable. Other associated costs of 0.10 – 0.20% are included for transaction and platform fees, however GAD note that the view of respondents from the initial call for evidence suggested that platform fees alone would be closer to the 0.25% mark. With all of this in mind, GAD's analysis indicates that tax

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[4] Ministry of Justice, Personal Injury discount rate: Exploring the option of a dual/multiple rate; call for evidence – page 2

[5] Government Actuary's Department, Setting the Personal Injury Discount Rate. Government Actuary's advice to the Lord Chancellor. 25 June 2019

[6] Ibid para 4.15 page 36

and expenses could be anywhere in the region of 0.60% - 1.70%. They settled on a deduction of 0.75% as they believe it was consistent with the returns analysis they modelled, based on the assumption that there is no active management involved.

Even by GADs own analysis for expenses, this is a significantly low deduction and does not reflect the expenses associated with a claimant's investment portfolio in practice. The principle aim of any reasonable financial advice to an injured claimant is not to generate greater return but to provide a structured financial plan to limit loss or recover loss where there has been an impact on their investment. We therefore suggest that the rates are reviewed to reflect that true extent of the work involved.

Additional considerations

Whilst lawyers representing claimants are seeking to obtain the appropriate level of compensation to put the claimant back in the position they would have been in but for the negligence, there are always a significant number of risks associated with that which impact on the level of damages. From a claimant's perspective, life expectancy, settlement compromise, and inflation can all negatively impact on the level of award.

Life expectancy

A claimant always faces a risk on life expectancy estimates. The estimates that underpin the Ogden tables result from a cohort of mortality estimates taking into account the possibilities of claimants living for different periods. There is always therefore a risk that compensation will have to last longer than accounted for.

Settlement compromise

This could be due to a liability risk or part 36 offer. Whatever the reason, there is a risk that this too will impact the level of damages.

Inflation

For personal injury investors who may be awarded damages for their lifetime, it creates a 'need' to invest the money rather than a 'desire' as they must attempt to achieve a return which at least matches inflation simply to preserve the value of their capital.

Given that most of their needs are for specialist goods and services, it is likely that a personal injury claimant will be looking to target a return of CPI +1% after tax and charges. Given that most of their needs are for specialist goods and service, it is likely that a personal injury claimant will be looking to target a return of CPI +1% after tax and charges.

The chart in Appendix B- *Inflation*, shows that rise in CPI, CPI+1%, the bank of England Base Rate, and the possible returns of a portfolio in line with GADs central model portfolio, over a 3 year period, since the new single PIDR came into effect on 05th August 2019.

Whilst this is a relatively short period of time, it shows that cash deposits are unable to match the level of inflation. However, it also shows that whilst investments have the ability to exceed inflation, the nature of investing also means that a claimant could make capital losses in periods of market stress and require a larger return at certain points in time in order to match inflation. This is particularly relevant to those claimants with short life expectancies, as the chart referenced above shows, they cannot afford to take such risks.

Ultimately, the chart shows us that investment markets don't provide a consistent positive return as is assumed in the GAD advice to the MOJ, however they provide the greatest potential to match or exceed the rate of inflation. A consistent return can be achieved through low-risk savings and investments however these are likely to fall significantly below the level of inflation leading to inflationary risk.

Personal injury claimants are required to take a certain level of risk in order to achieve a return which matches inflation, however this needs to be at as little risk as possible in order to ensure the likelihood of suffering capital losses is minimised in so far as possible.

APIL is concerned that that the proposed changes to the discount rate would further erode the individual's right to full compensation. We do not advocate for more compensation for individuals just the right amount of compensation. The principle of full compensation is key and yet it has been eroded by the above risks and the assumptions implemented in the 2019 reforms.

It is essential to understand the financial advice process that an injured person goes through. An adviser will follow a process similar to that noted below.

- Understand the individuals personal and financial circumstances;
- Identify the risks factors that the individual may be exposed to;
- Cash flow analysis;
- Implementation of investments;
- Regular reviews

It is wrong to assume that the injured person invests in the same way as an ordinary investor. They are not an ordinary investor and it should never be assumed that they will be prepared to take the same risks. Their compensation is all the money that some of them will have to meet their lifetime of need. It is also unfair and impractical to treat claimants as a basket of cases where risk can be shared

Question 1: Do you have a preferred model for a dual/multiple rate system based on any of the international examples set out in the Call for Evidence paper (or based on your or your organisations experience of operating in other jurisdictions)?

Please give reasons with accompanying data and/or evidence.

The move to a risk-based discount rate in 2019[7] was a significant change to the way in which the discount rate was calculated. Even with the Lord Chancellor's 0.5% adjustment to reduce the projected level of under compensation, one third of claimants were expected to be unable to 100% meet their financial losses. The financial instability and high inflation that have prevailed since then have in reality greatly amplified that expected level of under compensation. A move to a dual/ multiple rate would create further instability and has the potential to erode damages further.

A dual rate is founded on the historical principle that the longer an investor is prepared to invest their money the more risk they can take and consequently the better returns they can

[7] Statement placed by the Rt Hon David Gauke MP, Lord Chancellor, in the libraries of the Houses of Parliament on 15 July 2019

expect. However, it is crucial to understand that personal injury claimants are not ordinary investors. There are several misconceptions in the consultation paper relating to the investment traits of a claimant. A seriously injured claimant is often vulnerable. They worry about finances. The negligence will often have ended their ability to work and provide for their family. They will not have other income or money to support them. They often have no significant experience of investments and they do not want to take risks with their future financial wellbeing. They cannot afford to; they do not have other financial security to support them. In so far as they have to invest, they invest to try and meet their lifelong needs, rather than to generate any level of gain.

APIL has significant reservations about moving toward a dual/multiple rate system which will be evident in the answers to questions below. However, if there is to be any change from the current single rate in England and Wales APIL would prefer a different rate set to heads of loss. There are however, also caveats to this. We propose limiting the change to one head of loss, namely care and case management. This head of loss is usually the most significant in catastrophic injury claims. See question 5.

Question 2: What do you consider to be the main strengths and weaknesses of the dual/multiple rate systems found for setting the discount rate in other jurisdictions?

APIL has significant reservations about moving away from a single rate. In the paper produced by Edward Tomlinson [8] for JPIL[9] he examined the impact of a dual rate. His analysis showed that, based on the figures in the Government Actuary Department report from 2019[10], where ongoing future loss is more than 18 years the claimant will likely recover significantly lower compensation. The report also showed that a claimant with a smaller settlement would be worse off under a dual rate when compared to a single discount rate. This creates an additional burden on this group of claimants to take greater risk with their money to ensure that it lasts for their lifetime.

The analysis assumed the GAD's 2019 example short term rate of CPI-1.75% and a longer term rate of CPI+1.5% in its calculation as follows and arrived at the following conclusion:

Male Age, with normal LEx	Single PIDR (-0.25%)	Dual PIDR (-1.75% first 15 years 1.5% thereafter)	Percentage Difference
10	£868,900	£503,195	42.1%
20	£735,600	£465,621	36.7%
30	£608,300	£422,452	30.6%
40	£487,600	£373,532	23.4%
50	£373,000	£318,134	14.7%
60	£269,500	£258,943	3.9%
70	£178,100	£179,959	-1.0%

[8] Edward Tomlinson is a Chartered Financial Planner at IM Asset Management Limited. Edward acts as an expert witness on the structure of claimant's settlements and is predominantly instructed by claimant solicitors. Edward also provides financial advice to claimants whose claims have settled.
[9] Journal of Personal Injury Law 2022, Issue 3 – Dual Discount Rate, by Edward Tomlinson
[10] Government Actuary's Department, Setting the Personal Injury Discount Rate. Government Actuary's advice to the Lord Chancellor. 25 June 2019

"As can be seen, under a dual discount rate the percentage difference in the value of a claim can be more than 40% and it is only for those aged 70+, with a normal life expectancy, where a dual discount rate may provide a higher settlement. Under the two PIDRs I have compared, the crossover point is a term of 18 years. Where the ongoing future loss is longer than 18 years, a claimant will receive a smaller settlement under a dual PIDR.

Despite the percentage chance of a claimant being able to meet 100% of need being quoted as similar (66% chance for single PIDR & 70% chance for dual PIDR) there is a **40% difference between the two settlement values**. This is one of the challenges of moving to a dual discount rate. If a claimant has a 66% chance of being able to meet all their need under a single discount rate, how do they have a 70% chance of being able to meet all of their need under a dual discount rate with a 40% smaller settlement?

Knowing that both the single and dual PIDR are both "risk rates" then the claimant, under either discount rate arrangement, is expected to invest their compensation within a risk portfolio to be able to meet their ongoing need. If a claimant has a smaller settlement under a dual PIDR, when compared to a single PIDR, they will need to achieve a higher rate of investment return, when compared to a settlement under a single PIDR, to be able to meet their need. To achieve a higher rate of return the claimant under the dual PIDR must take more risk and therefore it is counterintuitive to suggest this claimant has the same or higher chance of meeting need."[11]

The GAD report suggests if a dual rate is to be adopted there should be a higher discount rate for those with longer life expectancy over which their losses are expected to continue. This of course puts additional pressure on this group of claimants. It requires them to take additional risks with their damages to ensure their compensation meets their needs for their lifetime. A longer life expectancy should not create an expectation of taking more risk nor that a claimant would achieve higher returns if he did so. The longer period for which they are having to plan exposes them to greater levels of risk of material departures from other assumptions on which the discount rate is set (e.g. tax, inflation, longevity etc). All this would do is create financial benefits for defendants.

In fact, the level of risk required for a higher long term rate is contrary to the assumption in section 10 of the Civil Liability Act 2018 namely that the damages are invested using an approach which involves "more risk than a very low risk but less risk than would ordinarily be accepted by a prudent and properly advised investor." ("the risk assumption").

A dual rate presupposes a floor as well as a ceiling rate which must still come within the risk assumption. APIL has seen no evidence to suggest such a range would be possible within the law as it currently stands.

We would go so far as to say that the current GAD central portfolio model already has a much higher risk profile than the risk assumption, (Appendix C – The 'risk assumption') and therefore if there were to be a shift to a dual rates the assumed long term portfolio must not have a greater risk profile than that currently and the short term rate should be even less risky.

It is clear that one small change to address a perceived problem for one group of claimants, impacts on another. Whilst the current single rate is not perfect, if set at an appropriate

[11] Page 174 Journal of Personal Injury Law, issue 3.

level, it provides the most stability for claimants and minimises the risk. PPOs can and should be encouraged to address the issues that arise for those with short life expectancy. In these cases, PPO's can be more beneficial for the claimant as they ensure that there is the right level of compensation for the individual's needs. They provide regular payments to meet their future losses. They also remove the risks associated with lump sum awards, namely life expectancy, inflation and tax.

Question 3: What do you consider is the optimal point for the switch-over from a short to a long-term rate on a duration-based dual rate model?

Please give reasons with accompanying data.

In the commentary that APIL has considered on this, there does not appear to be any consensus on what the optimal point for switch over would be. In the Government Actuary paper from 2019[12], it is suggested that the cut off period should be 15 years. The consultation document looks at the Ontario model which also utilises a 15-year switch over point, whereas Jersey uses 20 years. In this respect Hong Kong is unique in being the only system with a switch as early as 10 years, but with the added complexity of a triple rate for reasons that appear unique to the Hong Kong economy. A shorter-term rate if proposed should not be less than 10 years, see below question 4.

Question 4: What would you consider an absolute minimum and maximum point for the switch-over between two rates to be?

Please give reasons.

APIL suggests that if dual rates were to be adopted, the minimum and maximum points should be 10 and 25 years. In our view at the absolute minimum a short term rate ought not to be less than 10 years as severe economic cycles can take 8 years or more to resolve. However, it would probably be more favourable to adopt the position from the GAD[13] report in para 3.18 and Figure 5[14] which suggests that "broadly speaking, the returns settle after around 15 to 25 years".

Question 5: If a dual rate system were to be introduced, would you advocate it was established on the basis of the duration of the claim with a switchover point, on duration based on length of claim or its heads of loss (or a combination of the two)?

Please give reasons for your choice.

If a dual rate system is to be introduced, APIL would favour the rate based on heads of loss rather than a rate based on duration. However, even then we would favour limiting the change to one head of loss: care and case management. In our members' experience in

[12] Government Actuary's Department, Setting the Personal Injury Discount Rate. Government Actuary's advice to the Lord Chancellor. 25 June 2019 page 7
[13] Ibid
[14] Ibid pages 25 and 26

pursuing claims on behalf of those with injuries of the upmost severity, care and case management costs account for the most significant proportion of the claim. These claimants will face regular outgoings to pay for carers, case managers and therapists for their whole life. Those costs are subject to earnings growth and these can be expected to rise at a rate over and above other losses.

This change would fit well alongside the existing PPO regime, as most PPOs only relate to future care and case management and are indexed to the most relevant earnings inflationary measure. A different rate for costs relating to care and case management has been rigorously tested (including from expert economist and actuaries) in courts in numerous common law jurisdictions, including the Republic of Ireland, Guernsey and Bermuda. It has at least two material advantages over any change to dual rates by duration; (1) it would achieve close matching for one of the most significant risks (inflation), but (2) would not add significant complexity, as in most catastrophic injury claims the future loss of care and case management would be pleaded in the alternative, i.e a PPO or the applicable discount rate for care claims (set by reference to long-term inflationary trends for workers in the care sector).

Question 6: In dealing with volatility of markets over the short-term is it a reasonable assumption that short-term rates in a duration-based system should be more variable and set at a lower rate; and long-term rates more stable and set at a higher rate?

If you agree or disagree that this assumption is reasonable, please say why.

We agree that short term investment rates will be much more volatile and thus there is a significant risk that in a duration-based system those in the short term rate cohort will have to avoid investing in higher risk investments. Consequently, the assumed portfolio to meet their short-term needs will have to be heavily based on retaining funds in cash.

However, it is important to understand that claimants with short life expectancies would not be the only group of individuals affected by the introduction of a dual rate calculated on the basis of duration. Moving to a blended dual rate would affect all claimants, notably those who are not as catastrophically injured, who therefore have a smaller compensation award and higher life expectancy. See above at question 2.

Question 7: If short-term rates are more volatile, should frequency of review be increased?

Please explain your reasoning.

This volatility would be largely driven by inflation, rather than investment return (as claimants would simply have to avoid volatile investments). So, the short-term rate would need to be reviewed every year. We understand that to have been the position adopted in Ontario and in most years that has required an adjustment to their short term rate[15].

[15] Future pecuniary damage awards | Ontario.ca The table shows an adjustment in 15 out of 23 years.

Question 8: What would you regard as the advantages of a dual/multiple rate system?

In principle, and if it is accepted that there is a band of rates that meet the statutory risk assumption, then short(er) term losses are much more likely to be met by a lower discount rate than is currently derived from the assumptions used to set a single discount rate. However, claimants with life expectancies of less than 10-20 years are a very small cohort of all claimants whose needs in any event would be better met by PPOs (see additional comments below on PPOs). This is because the most significant risk they face is one of longevity (for which the GAD has not to date proposed any adjustment to the discount rate). APIL considers that any move to a dual rate by duration should not be at the cost of an increased risk of under compensation of longer-term losses. There is no evidence base for any assumption that claimants as a matter of fact take greater investment risk to ensure their long-term needs are met. Anecdotal evidence from experienced IFAs, professional deputies and trustees in this sector strongly suggests that catastrophically injured claimants are highly reluctant and risk averse investors. We reiterate that a higher rate for longer term losses must meet the statutory risk assumption. A lower rate for shorter term losses reflects the reality of a significantly lower (sub-inflation) return during such periods.

Question 9: What would you regard as the disadvantages of a dual/multiple rate system?

Changing to a dual or multiple rates creates further risks for claimants. Insurers have the benefits of assessing risk over a basket of cases, claimants do not. Any change affects a claimant individually. It can be seen in our answers to questions 2 and 6 that by implementing a change, purporting to benefit one small group of individuals (who would be better served by rules to strengthen the PPO regime), there is substantial potential to disadvantage the vast majority of seriously injured claimants. It is also worthy of note- as mentioned above (see question 1)- that these individuals were already affected by the discount rate change in 2019, with the GAD assuming that only two thirds of these individuals will be able to 100% meet their needs. A move to a dual or multiple rate would add significant uncertainty, extra complexity (with associated cost and delay) and further dilute the full compensation principle.

We have set out the administrative difficulties of a dual rate by duration below in answer to question 10.

Question 10: What do you consider would be the specific effects on implementing and administering the discount rate if a dual/multiple rate is introduced?

In setting any dual rate by duration, consideration would have to be given to the investment risk that it is reasonable to expect a claimant to take in the final period of their life. Rather like the initial period, most claimants would be advised against taking significant investment risks at a time when their care and medical needs are likely to be at their highest and when they are exposed to the greatest impact of the longevity risk. Whilst their life expectancy might only be for a further 10 years, they and their advisers will need to plan for the distinct possibility that they may materially outlive that expectation.

Further, there would be considerable practical implications to administering a dual rate. Each item of claim would need to be calculated based on each rate. So, for example, if you are representing an individual who is a paraplegic, they will have a significant schedule of loss. Their claim will often have ten or more heads of future loss. Taking the example of just one of those heads of loss -disability aids -they might have 40 or 50 disability aids listed, some of which are short, medium or longer term use. Some of these will need to be purchased yearly, some purchased at longer intervals such as every 3, 5, 10 or 20 years. If there were two rates based on duration, there would need to be two calculations for each item claimed. This of course would increase further if there were multiple rates. Currently catastrophic injury claim schedules are frequently 50 to 100 pages long with hundreds of individual calculations, so changing the discount model would significantly increase the complexity of these calculations.

These schedules once finalised are shared with the defendant and in most cases a counter schedule will be produced by the defendants' representatives. In large value cases this will be a line-by-line response, especially if a case is getting ready for trial. This will increase the costs being incurred in preparing these schedules significantly, both in preparing the schedule and with arguments over the items claimed. There is also an increased risk of error.

Such a change would almost certainly need for parties to consider using forensic accountants to assist in the drafting of schedules. This, in turn would lead to higher profit and disbursement costs and increased potential disputes at the costs budgeting phase.

See additional comments in question 9.

Question 11: In addition to specific effects, do you consider there will be additional consequences as a result of implementing a dual/multiple rate?

Please give reasons with accompanying data/evidence if possible.

See question 10

The annual change of the short term rate is likely to delay the pleading or negotiation of cases, pending any anticipated change that is likely to be beneficial to one or other party. It will also add uncertainty to advising on Part 36 offers, which could have unintended effects and, in the meantime, would cause uncertainty. There would also be additional costs associated with updating the calculations of future loss claims annually as many claims for serious injuries last for many years.

Question 12: If a dual/multiple PIDR were to be introduced would it be helpful to provide a lead in period to prepare processes, prepare IT changes etc. and if so, how long should this be?

Please provide reasons for your answer.

There needs to be sufficient lead in time for all concerned to be trained on the new methodology. Time would be required to enable new versions of the Ogden Tables (and PIBA Facts and Figures) to be produced.

Bringing in a rate at short notice would affect those cases where a Part 36 offer has already been made as they would need to be reviewed to evaluate whether the anticipated change in approach to the PIDR altered the merits of the offer made.

This needs to be weighed up against the risk of providing too much notice, which could delay settlements because of anticipated change. On balance we would favour a 12-month transitional period with an absolute minimum of 6 months, subject to relevant comments on timings from the Ogden working group and those that produce PIBA Facts and Figures.

Question 13: What do you consider would be the effects of a dual/multiple rate on a claimant's investment behaviour and what would this mean for the design of a model investment portfolio?

This question presupposes that a claimant's investment behaviour is affected or influenced by the PIDR. The effect of a dual or multiple rate is strictly limited to the way in which the parties and ultimately the court arrives at an appropriate award of damages. It is only the actual amount of damages recovered that dictates any claimant's subsequent investment behaviour.

In any event APIL considers that there appears to be significant confusion about an injured person's investment habits. See our answer to Q1. An understanding of what actually happens with regards to portfolio management and construction is crucial so that the statutory risk assumption is met given that the CLA 2018 allows for the Lord Chancellor to consider not just returns available to ordinary investors but actual investment behaviour by claimants (section 4(5)(b)).

In particular, for the first 5 years of the portfolio construction in a typical catastrophic injury case, investment types differ to that of subsequent years. In the first 5 years the claimant would need to hold more cash so as to allow the injured person to cater for any short term expenditure that is required. After 5 years the typical portfolio is unlikely to differ considerably, that is until the individual gets towards the end of their projected life expectancy. At this point projecting the discount rate becomes difficult due to the level of uncertainty.

Question 14: What do you think would be the effects of a dual/multiple rate on drawing up assumptions for tax and expenses when setting the discount rate?

As explained in our introduction, we do not believe that the current assumptions are correct as they do not reflect a claimant's investment practice.

The charges proposed in the 2019 GAD report do not reflect what a claimant would do in practice. The allowances for individual charges and tax are significantly lower than those experienced in practice.

Data obtained by FOCIS as part of the 2019 MoJ call for evidence on the discount rate, clearly demonstrated that an over whelming majority, some 64.3%, of the 389 portfolios, incurred investment charges of 1.5% and above (including 6.4% in excess of 2%). In comparison, only a small minority of claimants (4.9%) incurred charges below 1% and only 35.7% of the portfolios incurred charges of 1.5% and below. Furthermore, when looking solely at the 169 portfolios whose value fell below £1.5m, 74% of portfolios incurred charges between 1.5% and 2.0%, only 12.5% incurred lower charges and 13.6% incurred charges of 2% or more[16].

Question 15: What do you consider would be the effects of a dual/multiple rate on analysing inflationary pressures and trends when setting the discount rate?

As we set out in answer to questions 6 and 7, short term rates would be much more heavily impacted by inflationary pressures. Conversely, as set out in answer to question 5, a dual rate for the care head of claim would achieve closer matching for inflation. A potential formula for that close matching already exists though the widespread and long-standing use of ASHE 6115 (combining 6135 and 6136) for care PPOs.

Question 16: What do you consider would be the effects on claimant outcomes of a dual/multiple rate being adopted for setting the discount rate?

There are several risks that will negatively affect a claimant's outcome if the rates are to be changed. Any change affects a claimant individually. It can be seen in our answers to questions 2 and 6 that by implementing a change to, seemingly, benefit one small group of individuals there is substantial potential to disadvantage another. We therefore take the view that any change to a single rate will pose significant disadvantages to most or all seriously injured claimants.

Those with shorter life expectancy will have a discount rate that is constantly under review due to its uncertainly and instability, and which does not address the longevity risk they face. There is also a risk for those with a smaller financial settlement or longer-term losses, as they would likely be much worse off under a dual rate when compared to a single discount rate (if the rates are anything like those projected by GAD in 2019). This group of claimants would need to take greater risk with their money to have any chance of making it last for their lifetime. Inevitably some of those risks will not work in their favour and they will end up being under compensated and falling back on the State for financial and care support.

Question 17: If a dual/multiple rate was adopted would it be possible to return to a single rate in future reviews, or would a move be too confusing and complex and seen as irrevocable?

Please give reasons.

It is highly undesirable to chop and change. It is important that claimants have a period of certainly post 2019 changes. We have not yet undergone the first panel review since the new methodology was set. We would suggest a period of reflection.

[16] Page 19 FOCIS' response to the MoJ call for evidence on the discount rate 2019. See also Appendix 1 FOCIS data in relation to investment charges.

Question 18: What do you consider the respective advantages and disadvantages of adopting multiple rates would be, when compared with either a:

- **single rate; or**
- **dual rate.**

See our earlier comments in questions 2 and 6 in relation to the impact of a dual rate on claimants – the same issues would arise in adopting multiple rates. The administrative complexities set out in response to question 10, which would be further exacerbated if multiple rates were adopted.

Those with shorter life expectancy will have a discount rate that is constantly under review due to its uncertainly and instability, and which does not address the longevity risk they face. There is also a risk for those with a smaller financial settlement or longer-term losses, as they would likely be much worse off under a dual rate when compared to a single discount rate (if the rates are anything like those projected by GAD in 2019). This group of claimants would need to take greater risk with their money to have any chance of making it last for their lifetime. Inevitably some of those risks will not work in their favour and they will end up being under compensated and falling back on the State for financial and care support.

Question 19: If a heads of loss approach were adopted, what heads of loss should be subject to separate rates – care and care management costs, future earnings losses, accommodation, or any other categories?

If a head of loss approach were to be adopted, we favour a separate rate for care and case management costs only. Our view is that the impact of change should be limited as far as possible. As previously explained, this head of loss is often the most significant in a catastrophic injury claim. These costs are subject to earnings growth and these can be expected to rise at a rate over and above other earnings losses. Consistency with the approach to PPOs is important. See comments above at 10.

Question 20: Introducing a dual/multiple PIDR could result in increased levels of complexity for both claimants and compensators. Do you agree with the assumption that this complexity will stabilise and ease once the sector adapts to the new process?

Please give reasons.

The ongoing annual review of the short term rate would likely cause ongoing complexity and uncertainty as many catastrophic injury claims last 3-7 years.

Question 21: The Government remains interested in exploring the use of PPOs in relation to high value personal injury settlements. We would therefore welcome any submissions, data and/or evidence stakeholders may have in relation to the effective use of PPOs.

APIL conducted a survey of its members in 2020 that found that claimants struggled to obtain PPOs from insurers, but that they did not struggle to obtain PPOs from NHS Resolution. Of those claimants who had tried to obtain a PPO from an insurer:

- 88% found it difficult to obtain a PPO from an insurer. Their experience is that insurers always or very frequently sought to undertake negotiations on a lump-sum only basis.
- 82% said that insurers, in their experience, always or very frequently made 'lump sum only' part 36 offers and rarely proactively offered a PPO.

In contrast, of those members who had tried to obtain a PPO from NHS Resolution:

- 79% found it easy to obtain a PPO from NHS Resolution.

The Institute and Faculty of Actuaries regularly conducts research on PPO's, their latest research[17] shows that even since the discount rate change in 2019 uptake of PPO's is very low. The number of motor (non-MIB) PPO claims has been broadly decreasing since 2012[18]. Employers' liability and public liability claims fare no better, data shows that since 2015 only one claim has settled by way of PPO[19]. Whilst the claimant should always have a choice, more should be done to increase uptake of PPOs. APIL commissioned YouGov polling in 2021 which suggested that if they were seriously injured as a result of someone else's actions, more than half of people would prefer to receive some or all of their compensation in the form of a PPO:

- 39% of UK adults would prefer to receive some of the compensation in instalments and some as a lump sum
- 15% of UK adults would prefer to receive all of the compensation in instalments
- Just 35% of UK would prefer to receive all of the compensation at once, in one lump sum

This polling and the extensive use of PPOs in cases involving NHSR (and MIB) suggests there is strong claimant appetite for PPOs. The data produced by the IFoA shows that the MIB had more PPO's in 2018 to 2020 that all reporting motor and liability insurers[20]. This coupled with data obtained by APIL through a FOI which confirmed that 219 claims with a value of £1.7 Million plus, were settled by NHSR in 2019/2020, 160 (73%) of those were settled by PPO[21]. This suggests that their willingness to offer a PPO plays a significant part in PPO take up.

[17] Institute and Faculty of Actuaries, Periodical Payment Orders Working Party Update. 2021 Industry survey.
[18] Ibid page 10 and 11. Figure 4.
[19] Ibid page 12. Figure 7.
[20] Ibid page 73 and 74 Figure F 9, F10, F11 and F12.
[21] This response split claims into 'lower-value' claims (claims under £1.7mllion) and 'higher-value' claims (claims valued at £1.7 million+). £1.7 million was chosen as the cut-off point, as this broadly aligned with the IFoA's definition of a 'large' claim.

The Government published its response to the Solvency II consultation[22] in November 2022. Which stated that it would ensure the risk margin is changed to reduce the risk margin for long term life insurance business, including Periodic Payment Orders. It hoped that this would, free up substantial amounts of capital, safeguard against the risk margin becoming too large and too volatile during future periods of low interest rates, but in times of high inflation ensure insurers hold sufficient capital to meet future loss. The changes may help a little, but nowhere near enough to make a real difference. Insurers are still likely to be very resistant[23].

When appropriate and available, PPOs can be extremely beneficial to the claimant. They provide regular payments to enable seriously injured claimants to meet their needs, notably in relation to care. They have the significant advantage over lump sums calculated using the discount rate in that they remove from the claimant the significant risks posed by life expectancy, inflation, and tax.

APIL recommends that it is far more important for the Government to take steps to encourage the use of PPOs. This ought to be a clear and uncontentious policy objective. We know from the IFoA report that defendant insurer settlement behaviour is a large driver behind the very low rates of PPO[24] In Scotland PPOs are encouraged. Legislation[25] requires that where future losses are over £1million, either the court has to certify that a lump sum award, as opposed to a PPO is appropriate[26], or if it is an agreed settlement, an independent actuary has confirmed that is the position[27]. Other examples could include (1) requiring any Part 36 offers in cases involving future care claims of greater than £500,000 to include a PPO variant, or detailed written explanation of why such an offer would not be possible or not be in the claimant's best interests and (2) pro-active case management of the PPO issue, in applicable cases, at a much earlier stage in proceedings (eg case management conferences). In stark contrast the suggestion in this Call for Evidence is that a higher differential discount rate is used for cases involving a PPO, this would clearly discourage their use, without any associated clear-cut policy benefit. It would also add significant further complexity because at the point of drafting the schedule of losses and counter schedules it would be unknown whether the court would award a PPO. Both parties would have to produce variant calculations applying the standard and PPO variant discount rate for every one of the (often hundreds) items of claim. If combined with the suggestion of a dual rate by duration then four variant calculations would be required for every item of future loss claim.

Other comments

The consultation seeks views on whether there should be a different discount rate for cases where there is both a PPO and a lump sum. The Government assumes that using the CPI+1% inflation measure for lump sums where there is also a PPO will effectively overstate

[22] https://www.gov.uk/government/consultations/solvency-ii-review-consultation
[23] Spotlight on Periodical Payment Orders, how are insurers managing risks in 2022? Post magazine July 2022.
[24] Institute and Faculty of Actuaries, Periodical Payment Orders Working Party Update. 2021 Industry survey. Page 160
[25] Civil Litigation (Expenses and Group Proceedings) (Scotland) Act 2018. Section 6
[26] Ibid Section 6 (6) (a)
[27] Ibid Section 6 (6) (b)

the expected level of inflation for the future loss of earnings element and could lead to over compensation on that head of loss.

We consider CPI+1% to be an appropriate inflationary measure for the discount rate even in cases with a PPO. It is rare for PPOs to be for any head of claim other than care and case management. However, the remaining major heads of loss are very different from the typical CPI basket of goods and service.

Future loss of earnings is a loss that obviously rises in line with earnings inflation. We would be surprised if any reputable expert economist would argue otherwise and in the common law jurisdiction cases in which this point has featured the defendant's experts have not even seriously attempted such an argument[28]. It would also be contrary to the full compensation principles to expect claimants to take more investment risk with their future loss of earnings[29]. That would not be putting them back into anything like the position they would have been in had they never suffered the negligence inflicted by the defendant.

Future medical treatment and therapies is another major head of loss for seriously injured claimants, the majority of which is earnings related and where historically inflation is on average materially higher than CPI.

Disability aids and equipment do predominantly relate to purchasing goods, but many of them are low production specialist equipment which is not included in the CPI basket and are not subject to a fully competitive market for goods. Producers will often need to recoup significant research and product development costs across a relatively small number of customers. A prime example of this it to consider the comparative cost of the prosthetic that the same prosthetist would recommend today when contrasted to that recommended 20 years ago to a claimant with the same level/type of amputation. That cost has almost tripled, so significantly more than CPI inflation.

Housing costs are another major head of claim, but we contend are neutral for this point, because virtually all the funds are rapidly spent on purchasing and adapting a property to meet the claimant's needs. Hence there is no significant balance left to invest. In any event the law relating to compensating future accommodation expenses has recently been reconsidered by the Supreme Court in Swift v Carpenter.

Claimants who lack mental capacity will often have a significant head of loss for the cost of a professional deputy. Once again that is an earnings-related cost as it predominantly relates to the cost of time spent by that professional (usually a solicitor).

[28] *Colonial Insurance Company Limited v Thomson* (conjoined with *Harvey v Warren*) Court of Appeal for Bermuda in CIVIL APPEAL No. 13 of 2015

[29] The Civil Liability Act (2018) confirmed that when setting the personal injury discount rate the Lord Chancellor must have regard to the actual investments made by investors of relevant damages'

Section (3) In making the rate determination as required by sub-paragraph (2), the Lord Chancellor must make the following assumptions—

(d) the assumption that the relevant damages are invested using an approach that involves—
(i) more risk than a very low level of risk, but
(ii) less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.

In conclusion we submit that there are advantages to a separate PIDR to close match earnings inflation for care and care management costs only, akin to the position for claims with PPOs for care, but CPI+1% would remain the most appropriate inflationary measure for the PIDR for all other heads of loss as they contain a mixture of items many of which are driven by earnings inflation and/or by medical/technological advancements that cause rises in cost well above CPI.

Question 22: Do you agree that using a higher PIDR to calculate the real rate of return in settlements which include a lump sum element would result in a more appropriate way to adjust nominal investment returns for future inflation?

Please give reasons.

We suspect this question is intending to refer to settlements with a PPO element. If so we disagree for the reasons set out at Q21 above.

Question 23: What impact would a dual/multiple rate system have on protected characteristic groups, as defined in the Equality Act 2010?

The discount rate affects those who are seriously injured. Therefore, by definition they are likely to have disabilities characterised under the Equality Act 2010.

Many claimants with claims for catastrophic injuries are children or adults with mental incapacity, thus requiring more extensive financial advice and assistance with investing their compensation. Yet they are adversely impacted by the 2019 assumption that they only require a passive management approach.

In addition to this there is also the discriminatory affect that the proposed changes will have the group of claimants with lower compensation but continuing loss. The proposals will create an expectation that greater investment risk must be taken, leading to a greater risk of under settlement, this departs from the Governments stated committed to full compensation[30]

Any questions in the first instance should be addressed to Abi Jennings, head of legal affairs at APIL abi.jennings@apil.org.uk

Thanks go to:

Julian Chamberlayne, Stewarts Law.

Gordon Dalyell, Digby Brown.

Stephen Glynn, Deka Chambers.

Paul Rosson, Adroit Financial Planning.

Jonathan Scarsbrook, Irwin Mitchell.

[30] Ministry of Justice. Personal injury discount rate. Exploring the option of a dual/multiple rate. Call for evidence. Page 2.

Appendix A- Further detail regarding tax and fees

Paul Rosson
Principal Financial Consultant
Adroit Financial Planning Ltd

Tax

The rates and allowances for the current (2022/23) tax year are as follows:

2022/23 Tax Year:

Tax Allowances:

Income Tax Personal Allowance	£12,570
Income Tax - Personal Savings Allowance	£1,000 Basic Rate taxpayers, £500 for Higher Rate Tax Payers
Dividend Allowance	£2,000.00
Capital Gains Tax Annual Exemption	£12,300.00

Tax Bands & Rates

Rate	Tax Band	Income tax rate	Dividend tax rate	Capital Gains Tax
Starting Rate for Savings	£0 - £5,000	0%	N/A	N/A
Basic rate	£0 - £37,700	20%	8.75%	10% (18% for property)
Higher Rate	£37,701 - £150,000	40%	33.75%	20% (28% for property)
Additional Rate	£150,001+	45%	39.35%	

From 2023/24 tax year the additional rate tax bracket will be reduced from £150,000 to £125,140, meaning those with taxable income above £125,140, will pay an additional 5% in tax compared to the current tax year.

From the 2023/24 tax year, the Capital Gains Tax (CGT) annual exemption is being reduced to £6,000, and will be further reduced to £3,000 from the 2024/25 tax year. As such any gains realised above these exemptions will be subject to tax at the individual's marginal rate.

From the 2023/24 tax year, the dividend allowance will also reduce from £2,000 to £1,000, and further reduced to £500 from the 2024/25 tax year.

The way in which tax is calculated is to combine the income from all sources to determine the individual's marginal rate. The tax after allowances is then applied at the marginal rate. For the current tax year an individual can earn up to £50,270 in income without becoming a higher rate tax payer, and this is now due to be frozen until 2028. However, of this income, a total of £2,000 can be generated from dividends and £1,000 can be generated from savings income without being subject to tax.

Some personal injury claimants are no longer able to work and may not be in receipt of any earnings income, however some state benefits are taxable. In addition, any ill-health pension benefits may also be taxable, therefore it is difficult to determine the tax drag as tax is a very personal matter.

However, if we consider a claimant who receives £2,000 in dividends from their investment portfolio, £1,000 from any savings they hold and has further income of £15,000, we can investigate how the recent changes in tax rates and allowances would affect their tax position.

The total income in this example would be £18,000 meaning the claimant would be a basic rate tax payer. £12,570 of the further income would be within the allowance, whereas the dividends and savings income would be within the allowances and therefore not subject to tax. The total income tax due would therefore be:

Further Income	-	(£15,000 - £12,570) x 20%	=	£486
Dividend Income	-	(£2,000 - £2,000) x 8.75%	=	£0.00
Savings Income	-	(£1,000 - £1,000) x 20%	=	£0.00
Total	**-**		**=**	**£486**

However, the same income would lead to a different tax liability in 2023/24 and 2024/25 as illustrated below:

2023/24 tax year:

Further Income	-	(£15,000 - £12,570) x 20%	=	£486
Dividend Income	-	(£2,000 - £1,000) x 8.75%	=	£87.5
Savings Income	-	(£1,000 - £1,000) x 20%	=	£0.00
Total	**-**		**=**	**£573.50**

2024/25 tax year:

Further Income	-	(£15,000 - £12,570) x 20%	=	£486
Dividend Income	-	(£2,000 - £500) x 8.75%	=	£131.25
Savings Income	-	(£1,000 - £1,000) x 20%	=	£0.00
Total	**-**		**=**	**£617.25**

The above illustration shows that based on the upcoming changes to the tax allowances, the claimant would be paying a greater level of tax in future years, albeit remaining a basic rate tax payer with the same level of income. In 2023/24 their tax liability would increase by 18%, and in 2024/25 their tax liability would increase by 27% compared to the current 2022/23 tax year.

<u>Fees</u>

GAD's advice to the Government suggested that evidence from the initial consultation provided for advice fees of 0.25-0.50%. For fund management charges GAD believe that a fee of 0.25 – 0.50% should be factored in, however this is based on the client investing statically in low cost passive funds and includes any VAT payable. Other associated costs of 0.10 – 0.20% are included for transaction and platform fees, however GAD note that the view of respondents from the initial call for evidence suggested that platform fees alone would be closer to the 0.25% mark. With all of this in mind, GAD's analysis indicates that tax and expenses could be anywhere in the region of 0.60% - 1.70%. They settled on a deduction of 0.75% as they believe it was consistent with the returns analysis they modelled, based on the assumption that there is no active management involved.

Even by GADs own analysis for expenses, this is a significantly low deduction and does not reflect the expenses associated with a claimant's investment portfolio in practice.

GADs reasoning for using a low level for expenses was that using higher rate would not accurately reflect the return assumptions which are based on an static asset allocation and investment into passive funds. Again, this is not a reflection of how investment portfolios for claimants are established.

Even if the client had a portfolio which was constructed using passive investment funds, the claimant would require an investment professional (whether it be a financial adviser or a discretionary fund manager) to set the asset allocation and adjust the portfolio so it does not fall out of kilter with the risk mandate or asset allocation. This would be required even if we were to consider a static asset allocation for the entire investment term as the allocation would naturally move based on market performance.

With that being said, it is unlikely that a claimant would hold a portfolio constructed using only passive funds. Whilst passive funds can offer a cheap way to track an investment market, which can add value in times of market growth, there is little protection in a declining market, as the same funds would track the negative performance too. Whilst it would not be a claimant's intention to achieve a high rate of growth, any individual making an investment would want to achieve a positive return. The best way in which to do so is to restrict losses in times of market decline and take advantage of opportunities in times of market growth. In our view the best way to go about this is to invest in an actively managed portfolio.

The chart below shows the cumulative growth of a portfolio constructed of tracker funds, and a portfolio constructed of active funds, in the same allocation as the GAD Central Model, from August 2019 to August 2022 i.e. a three year period since the current PIDR came into effect. Also included is the GAD Central Model Portfolio which tracks the performance of each asset class (rather than any funds), as well as CPI.

Pricing Spread: Bid-Bid ● Data Frequency: Daily ● Currency: Pounds Sterling

The chart shows that over the three-year period, the tracker portfolio fell short of the GAD Central Model in terms of performance, mainly because it tracked the negative performance (Feb – Apr 2020), and was unable to recover these losses as the portfolio would not be taking advantage of growth/income opportunities. Conversely, the Active Portfolio has outperformed the tracker portfolio and the performance of the asset classes themselves, and provided a return which is much closer to the rate of inflation over the same period.

Investing in active funds, or having some form of active management within a portfolio e.g. by utilising a discretionary fund manager is likely to offer outperformance, however this isn't to provide a large return, it is to restrict or recover from losses. This is particularly crucial in the earlier years and later years of the investment term.

The importance of each service provider's role should also not be overlooked. With a typical claimant investment, there should be a financial adviser, a discretionary fund manager as well as the underlying holdings which may include additional fund managers depending on the composition of the portfolio. Each entity would have their own role to play to assist the client in ensuring the award can be utilised effectively towards their needs;

Financial Planning – this entails structuring a client's finances to ensure that their financial objectives can be met. It is mainly conducted by an Independent Financial Adviser (IFA) whose role is to discuss and document the client's personal and financial circumstances, their needs, objectives, assets liabilities, income expenditure attitude towards investment risk and capacity for loss. It is then their job to research and recommend a suitable financial plan including the relevant financial solutions, encompassing the relevant tax wrappers, cash solutions and investment products. They are also responsible for the on-going servicing of the financial plan including regular reviews of the financial solutions to ensure they remain suitable throughout the investment term. This could include performing tax calculations or making additional recommendations to provide suitable liquidity in a tax efficient manner throughout the life of the plan.

Investment Management – this entails the construction and management of a suitable investment portfolio as part of the wider financial plan. Whilst this can be undertaken by an IFA, the use of Discretionary Fund Managers (DFM) can offer greater focus and a wider range of investments, with an actively managed approach for greater control of income, growth and risk in line with a given mandate.

Typically, financial advisers and discretionary fund managers would take an annual charge as a percentage of the value of the investment portfolio, likely to be in the region of 0.35 – 0.75%. Using the mid-point, would provide an expense of 0.55% for each service. This would be in addition to the on-going fund charges and any transaction/ancillary expenses such as platform charges. In my experience, on-going fund charges can range from 0.45% - 0.85%, the midpoint being 0.65%.

As such, the total expense is likely to be closer to 1.75% for a claimant who has been properly advised.

Appendix B- *Inflation*

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The rate of inflation is determined by consumer demand. If there is more demand for a particular product or service, then the price is inflated to control consumer demand. As such when there is a sudden increase in demand the price can be pushed higher at a quicker rate. Demand may increase for several reasons; it could be that there are fears regarding supplies causing consumers to 'stock up' on certain goods, or it could be that demand for a particular service has increased due to environmental or other economic factors (such as reduced supply, as we have seen in recent years, as a result of COVID 19).

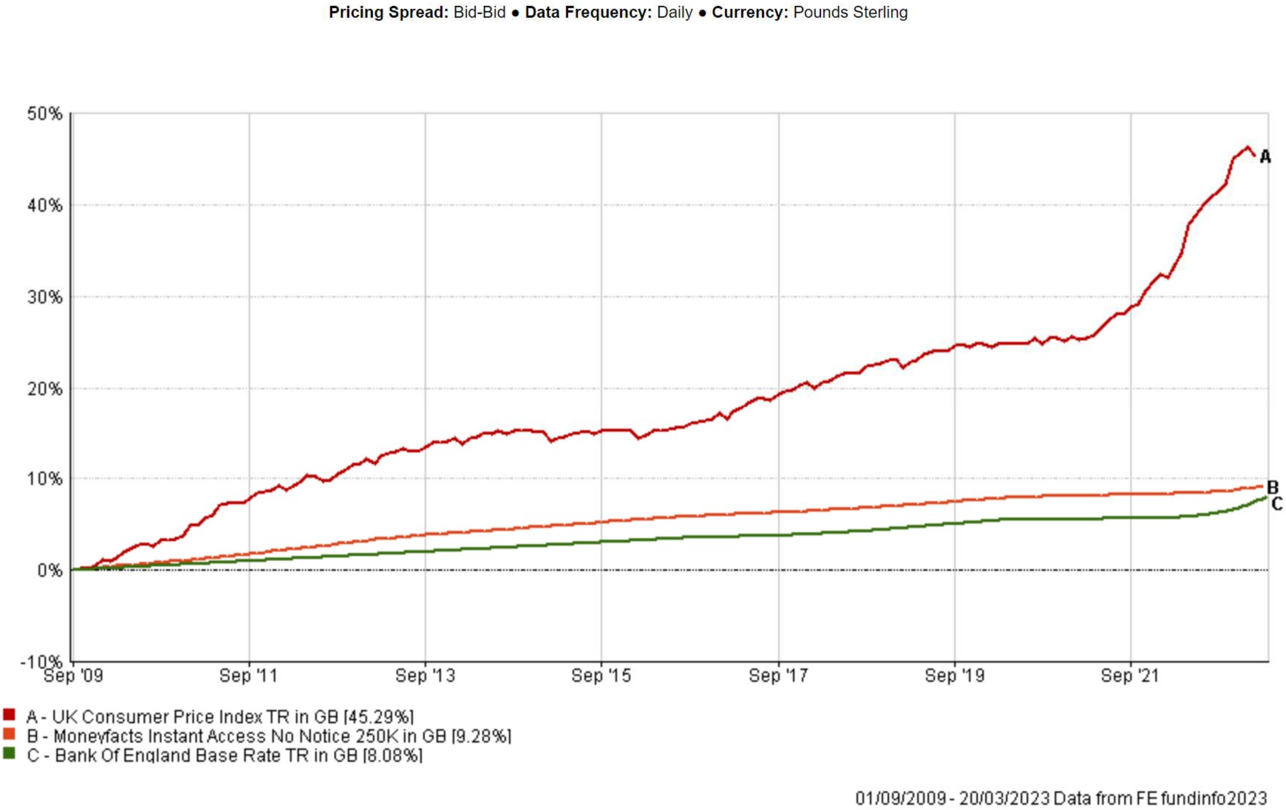
The bank of England has a target rate for inflation of 2% for CPI over the long term. Inflation is controlled by the Bank of England's monetary policy i.e. the setting of interest rates for deposits and borrowing, and generally follows the principles of supply and demand.

When inflation is at a higher rate, the Bank of England may decide to increase interest rates. The purpose of this is to dampen down spending by providing an incentive for consumers to save their money, or to borrow less for spending on products and services, as borrowing will cost more as a result of higher interest rates.

Conversely, when inflation is falling, the Bank of England would reduce the interest rates to de-incentivise consumers from holding their money on deposit, and make borrowing cheaper to provide cashflows for consumer spending.

However, interest rates on deposit accounts are very unlikely to exceed the rates of inflation at any time. If interest rates are higher than increasing costs of products and services, then consumers are incentivised to hold funds in cash deposits as they would make a profit over their costs. This is damaging for the economy as there would be less output from domestic businesses, leading to less tax and a lower overall GDP.

As such holding funds in cash solutions for a long period of time is always likely to lead to inflationary risk as the rates of interest are unlikely to exceed inflation over the long term. This is illustrated in the chart below when we compare the Bank of England Base Rate, MoneyFacts instant Access Account Average Interest Rate index, and CPI

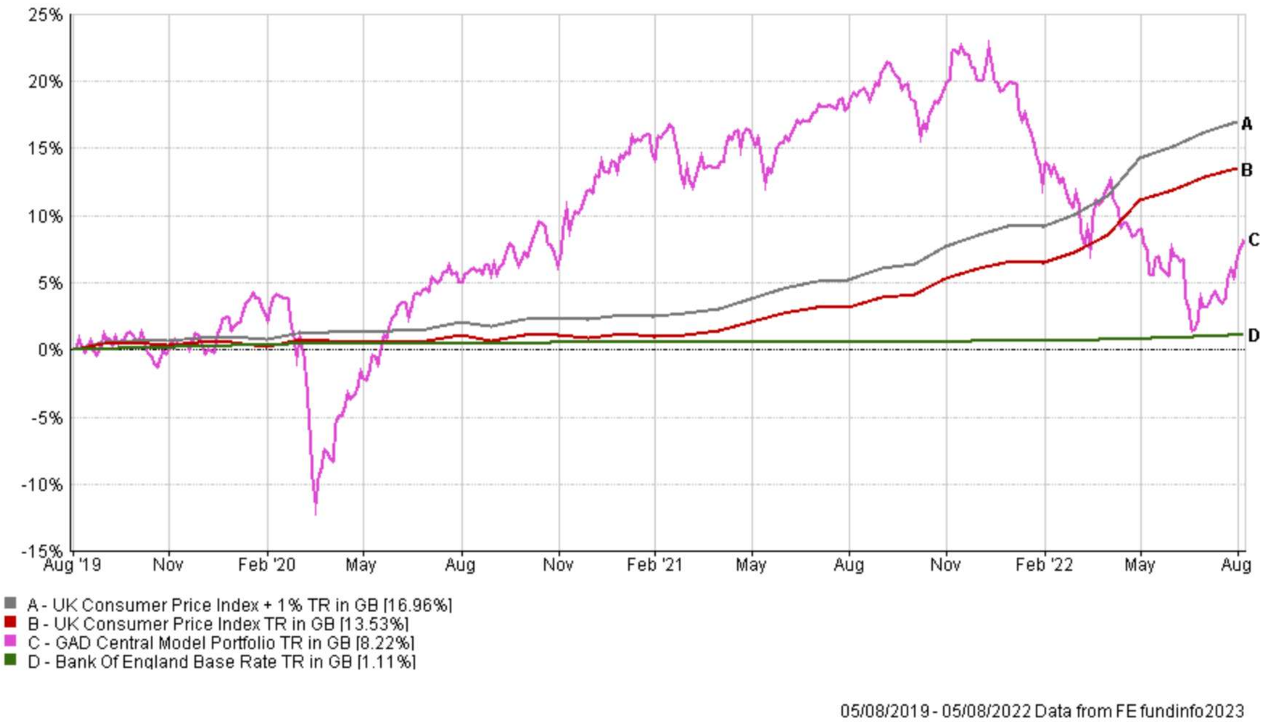


For personal injury investors who may be awarded damages for their lifetime, it creates a need to invest the money rather than a desire as they have to attempt to achieve a return which at least matches inflation simply to preserve the value of their capital.

Given that most of their needs are for specialist goods and service, it is likely that a personal injury claimant will be looking to target a return of CPI +1% after tax and charges.

The chart below shows the rise in CPI, CPI+1%, the bank of England Base Rate, and the possible returns of a portfolio in line with GADs central model portfolio, over a 3 year period, since the new single PIDR came into effect on 05th August 2019:

Pricing Spread: Bid-Bid ● Data Frequency: Daily ● Currency: Pounds Sterling



The table above shows whilst this is a relatively short period of time, it shows that cash deposits are unable to match the level of inflation. However, it also shows that whilst investments have the ability to exceed inflation, the nature of investing also means that a claimant could make capital losses in periods of market stress and require a larger return at certain points in time in order to match inflation. This is particularly relevant to those claimants with short life expectancies, as the above chart shows, they cannot afford to take such risks.

Ultimately, the chart shows us that investment markets do not provide a consistent positive return as is assumed in the GAD advice to the MOJ, however they provide the greatest potential to match or exceed the rate of inflation. A consistent return can be achieved through low-risk savings and investments however these are likely to fall significantly below the level of inflation leading to inflationary risk.

Personal injury claimants are required to take a certain level of risk in order to achieve a return which matches inflation; however, this needs to be at as little risk as possible in order to ensure the likelihood of suffering capital losses is minimised in so far as possible.

Appendix C – The 'risk assumption'

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The current PIDR assumes that the entirety of the monies are invested on day one in line with the central model portfolio, which adheres to the risk assumption as stipulated in the Civil Liability Act 2018, i.e.:

> the assumption that the relevant damages are invested using an approach that involves—
> (i)more risk than a very low level of risk, but
> (ii)less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.

When I advise on personal injury client portfolios, I use the ARC (Asset Risk Consultants) Private Client Indices as a benchmark to assess performance and risk, as this is a widely recognised indices in the investment world that is also regularly used for benchmarking by professional Deputies and Trustees.

The PCI are a peer group comparison tool designed to provide an understanding of the performance generated by discretionary private client investment managers. The Indices are based on real performance numbers provided by participating investment managers and focus on high quality data with no model or synthetic data being used.

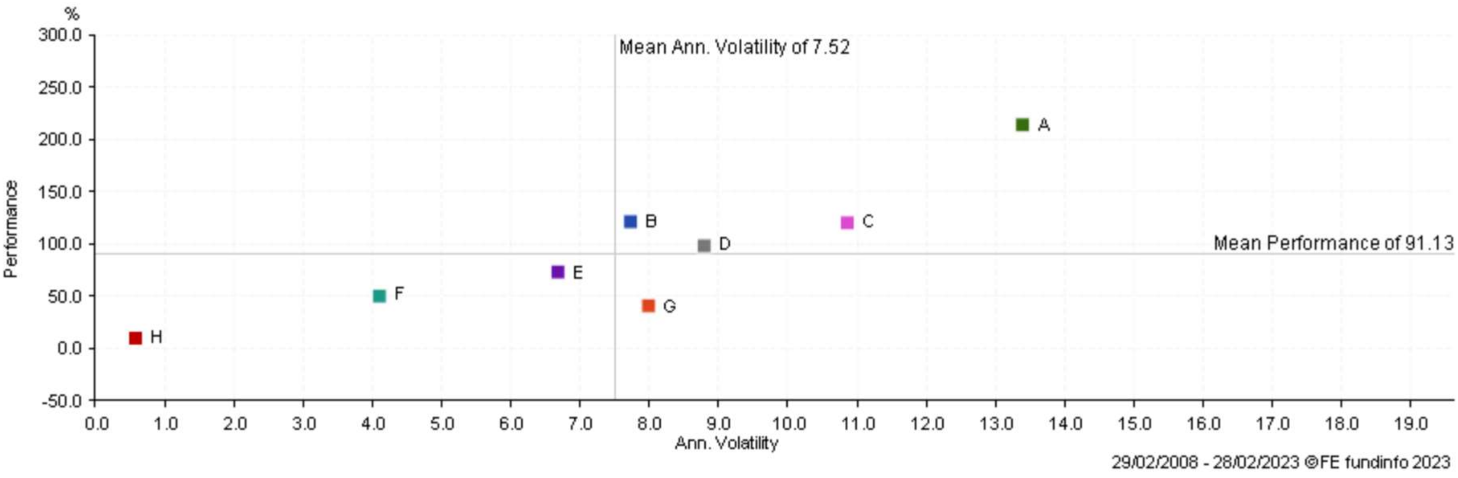
ARC provide four risk rated indices which are based on the actual returns of real portfolios from 90 different providers. As such it serves as a suitable indication as to the average return that can be expected from portfolios with a similar risk rating. ARC use the data submitted to group portfolios into 4 Indices based on the risk relative to world equities:

ARC Sterling Cautious – Equity content 0-40%
ARC Sterling Balanced – Equity Content 40-60%
ARC Sterling Steady Growth – Equity Content 60-80%
ARC Sterling Equity Risk – Equity Content 80-100%

Given that the GAD central model portfolio is based on having 42.5% in 'growth' assets, it would be reasonable to assume that the ARC Sterling Balanced PCI would serve as a suitable benchmark when assessing risk and returns.

The chart below shows the four ARC indices, along with cash, equities, UK Gilts and the GAD central model portfolio, to investigate where the model portfolio sits in terms of its historic risk/return statistics. The data is only available for a period of 15 years, therefore this is the timescale used to show the long term risk and return statistics for each.

Pricing Spread: Bid-Bid ● **Currency:** Pounds Sterling



ey	Name	Performance	Annualised Volatility
A	UT Equities TR	213.94	13.39
B	GAD Central Model Portfolio TR in GB	121.54	7.73
C	ARC Sterling Equity Risk PCI TR in GB	120.38	10.86
D	ARC Sterling Steady Growth PCI TR in GB	98.43	8.79
E	ARC Sterling Balanced Asset PCI TR in GB	73.40	6.68
F	ARC Sterling Cautious PCI TR in GB	50.19	4.10
G	UT UK Gilts TR in GB	41.19	7.99
H	UT Cash/Money Market TR	9.98	0.58

To explain the chart above; plot ‘H’ is cash and shows the lowest level of risk (across the X axis) but also the lowest return (along the Y axis). Plot ‘A’ shows the same for Equities i.e. a higher return but also a much higher risk rating.

Plots ‘F’, ‘E’, ‘D’ & ‘C’ are the four ARC indices going up in risk order i.e. F being the ARC Sterling Cautious Index and C being the ARC Sterling Equity Risk index. Plot E is the ARC Sterling Balanced Index.

In theory we would expect the GAD Central Model Portfolio to be in between or close to the Arc Sterling Cautious and Balanced indices. Instead, the chart shows the GAD Central Model Portfolio (Plot ‘B’) as being in between the ARC Sterling Balanced and Arc Sterling Steady Growth indices. In our view, this is between a level 4 and level 5 risk profile (on a scale of 1-10).

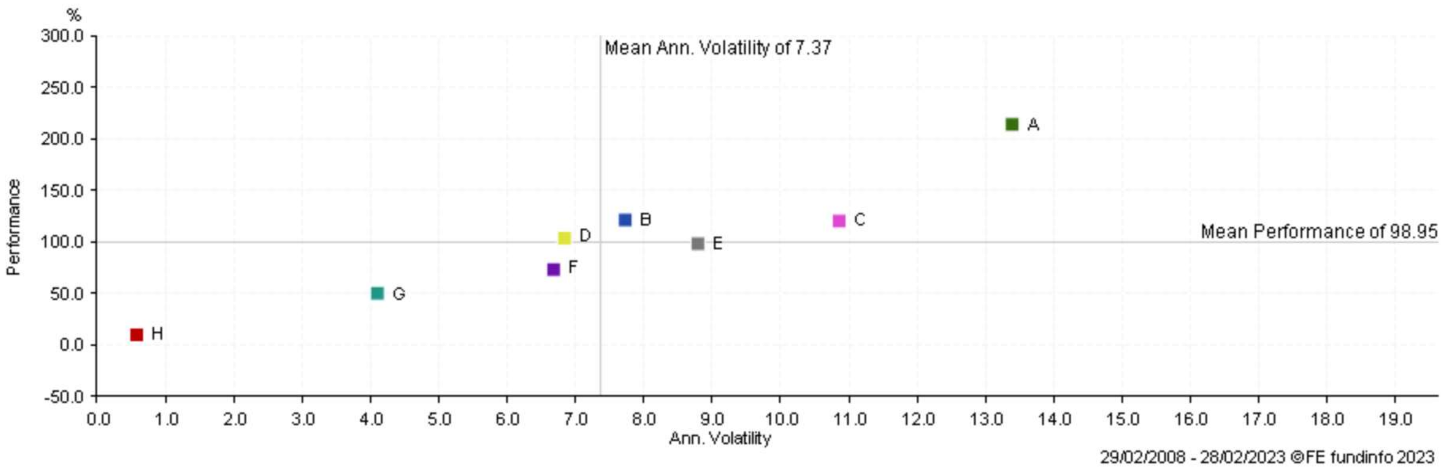
In practice, a claimant would not invest the entirety of their award on day one. Instead, they would hold a suitable sum in cash solutions to cater for their short term needs, meaning their asset allocation on day one would be more akin to the following:

	GAD Central Model Portfolio	**The Likely Exposure to Asset Class in Year One for a PI Claimant**
Cash	10.00%	36.24%
Gilts	30.00%	21.25%
Corporate Bonds	17.50%	12.40%

Equities	32.50%	23.03%
Alternatives	10.00%	7.08%

The same scatter chart as before with the PI claimant's more likely portfolio would look as follows:

Pricing Spread: Bid-Bid ● **Currency:** Pounds Sterling



Key	Name	Performance	Annualised Volatility
A	UT Equities TR	213.94	13.39
B	GAD Central Model Portfolio TR in GB	121.54	7.73
C	ARC Sterling Equity Risk PCI TR in GB	120.38	10.86
D	PI Claimant Portfolio (Year 1) TR in GB	103.77	6.84
E	ARC Sterling Steady Growth PCI TR in GB	98.43	8.79
F	ARC Sterling Balanced Asset PCI TR in GB	73.40	6.68
G	ARC Sterling Cautious PCI TR in GB	50.19	4.10
H	UT Cash/Money Market TR	9.98	0.58

As can be seen from the chart, the actual allocation of a claimant portfolio (Plot 'D') would be closer to the ARC Sterling Balanced Index as we would expect. In comparison to the GAD Central Model Portfolio it would entail less risk, but it would also be subject to a reduced return by comparison.

Whilst the actual investment portfolio may be aligned to the GAD central model portfolio, the discount rate ignores the cash holdings outside of the investment portfolio which would also be held in order to provide liquidity and protection against downside risk in the earlier years. As such the required return for PI claimants by virtue of the discount rate would in fact require more risk than the CLA 2018 stipulates. It is my view that the GAD model does not meet the principles of the CLA 2018, as it appears to take significantly more risk, as demonstrated in the above charts.

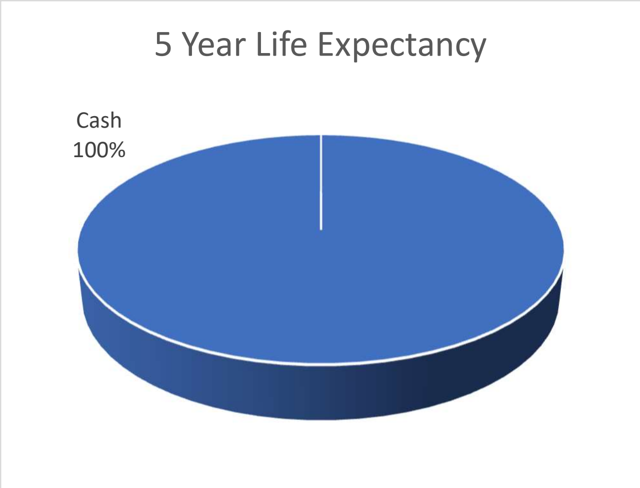
The portfolio itself can also differ with shorter life expectancies. If we consider three claimants, who have all received £1,000,000, but have life expectancies of five years, 10 years and 43 years respectively, we can see the difference in the exposure to each asset class.

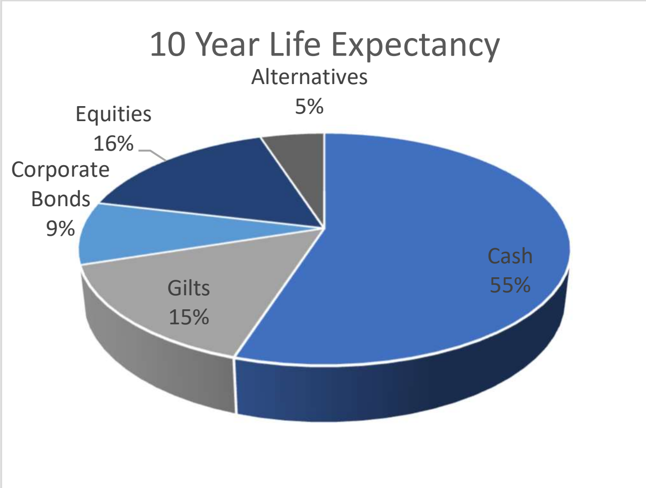
A claimant with a five year life expectancy is unlikely to hold any investment portfolio, but keep the entirety in cash solutions. This is to ensure that the capital is not subject to any capital losses by virtue of investment performance, as it would have very little time to recover.

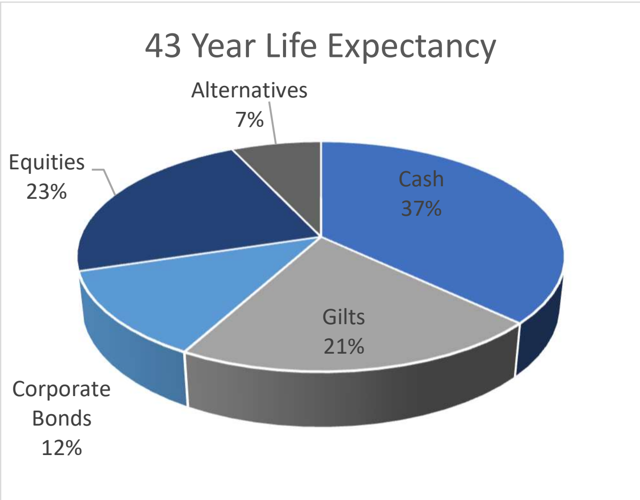
For a claimant with a 10 year life expectancy, we would likely hold at least five years' worth of expenditure and any capital expenditure needs in cash solutions, along with a general contingency, whilst investing the remainder. As such we would possibly be keeping around 50% of the award in cash solutions whilst the remainder is invested.

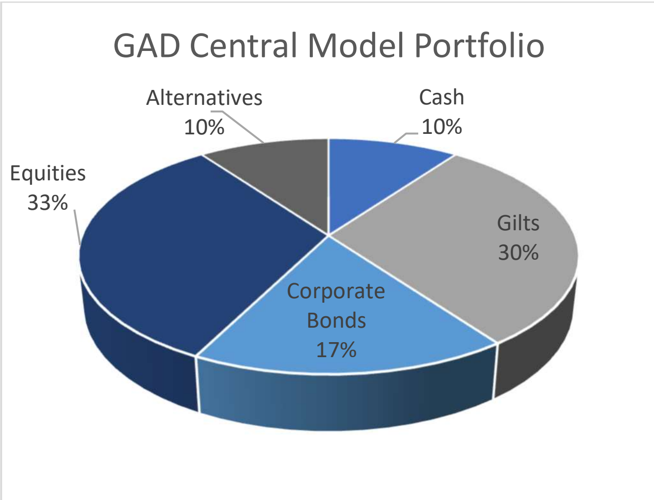
A similar plan would be set up for the claimant with a 43 year life expectancy, however as more of the funds would be required for the longer term, it is likely that we would hold around 33% in cash solutions whilst investing the remainder.

In the charts below I have shown the likely starting asset allocation for each of these three plans, as well as the GAD Central Model:



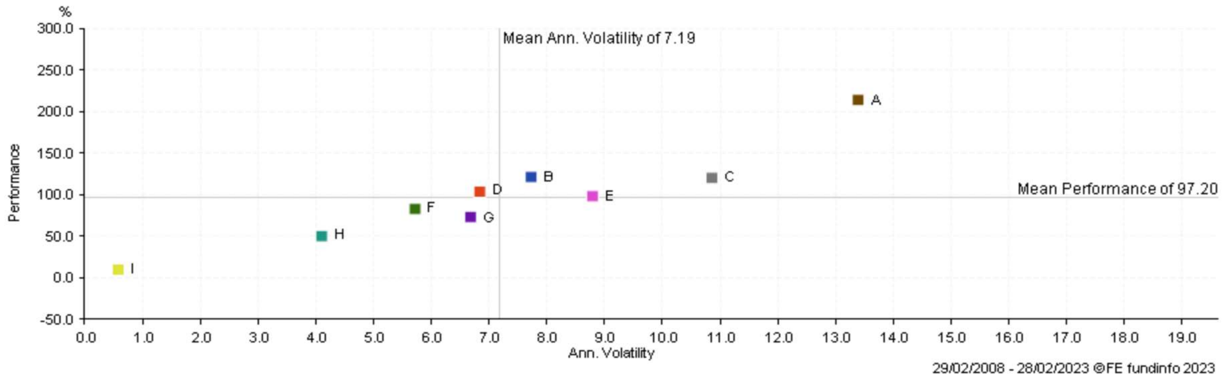






To get an idea of the risk/return characteristics, these allocations are plotted on a scatter chart, similar to the one previously shown:

Pricing Spread: Bid-Bid • **Currency:** Pounds Sterling



Key	Name	Performance	Annualised Volatility
A	UT Equities TR	213.94	13.39
B	GAD Central Model Portfolio TR in GB	121.54	7.73
C	ARC Sterling Equity Risk PCI TR in GB	120.38	10.86
D	PI Claimant Portfolio 43 Year Life Expectancy TR in GB	103.77	6.84
E	ARC Sterling Steady Growth PCI TR in GB	98.43	8.79
F	PI Claimant Portfolio 10 Year Life Expectancy TR in GB	83.13	5.72
G	ARC Sterling Balanced Asset PCI TR in GB	73.40	6.68
H	ARC Sterling Cautious PCI TR in GB	50.19	4.10
I	UT Cash/Money Market TR	9.98	0.58

Plots ‘F’, ‘D’ and ‘B’ show the portfolios for a 10 year life expectancy, a 43 year life expectancy and the GAD Model Portfolio respectively. As can be seen the 10 year life expectancy portfolio takes significantly less risk in comparison to the GAD Central Model Portfolio but also has a lower return. The same can be said for a portfolio for a 43 year life expectancy.

<ends>