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Discount Rate Update

The Impact of the Rate Cut/Implications for Consideration/Periodical Payments

Presentation by

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- Timeline of Consultations
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History

- Prior to Wells v Wells being heard by The 'HOL' in May 1998 no order had been made under section 1(1) of the Damages Act 1996.
- Multipliers prior to Wells' decision reflected a discount rate of 4% to 5%.
- Did not take into account the effects of inflation and allowed only for a rough and ready calculation for tax.
- Rate was derived by what Lord Diplock referred to as *"Interest rates appropriate to times of stable currency"*
- Following decision in Wells' rate was set at the then current net rate of return from ILGS which was 3%.
- Amended by Lord Irvine in 2001 who prescribed the 2.5% rate still in use today, well until 20th March 2017!

History

- ‘The House of Lords in *Wells* had held that when assessing damages for future loss and expense in PI cases, the Court should fix the award assuming that the Claimants would invest their damages in index linked Government Stock (ILGS) since this was the most accurate way of calculating the present value of the loss which they would suffer in real terms;’

- The majority of their Lordships considered it appropriate to set a discount rate by taking a three year average of ILGS yields and the Lord Chancellor proposed the same approach.

History

- At the time of setting the discount rate the three year average gross yield on ILGS was 2.46% with a net yield (assuming 15% tax) of 2.09%.
- This was rounded up to 2.5% to be ‘fair’ to the defendants.

The Timeline of Consultations

8th November 2010
TSOL announces that Lord Chancellor will commence a review 'Shortly'

12th Feb to 7th May 2013
Consultation 2.
The Legal Framework surrounding the Discount rate

March 2015
Expert Panel Appointed Dubbed 'The Three Wise Men'

27th February 2017
LC announces dramatic cut in the discount rate to -0.75%

1 | 2 | 3 | 4 | 5 | 6 | 7 | 8

1st Aug to 23rd Oct 2012
Consultation 1. How the discount rate should be set

September 2014
MOJ Tender for 'Expert Advice' on setting the discount rate

September 2015
Report presented to Lord Chancellor on the findings of the panel

27th February 2017
New Consultation announced to commence before Easter 2017

Too far? Not Enough ??

- Damages Act 1996 gives a general power to set a discount rate
- Legislative history of the Act is drawn from principle of ‘full compensation’ from ‘risk-free’ investment and LC felt unable to depart too far from that principle
- However did ‘LC’ go far enough? What is the current ‘Yield on ILGS’ based on the Wells calculation.
  - 5 year and longer ILGS were used (2001 all ILGS) were used.
  - 3 year average yield rate used. To reflect that rates have increased/improved over the last three years
  - No adjustment for tax (rightly so) as the burden for tax has been removed
  - No rounding as per Lord Mackay to balance the interests of both parties

Too far? Not Enough ??

- “The Lord Chancellor must only consider the impact on the victim. I do not think that the procedure works in the right way, which is why I will shortly bring forward a consultation on a better way to set the discount rate.”

- “It is important that going forward, personal injury discount rates are set at a level that is fair to both claimant’s and consumers. The Government will progress urgently with a consultation on the framework for setting future rates and will bring forward any necessary legislation at an early stage.”

Index Linked Yields

Updated	Issuer	ISIN	Cpn	Maturity	Life	Price	Yield
14 Mar 2017	UK Gilt Index-linked Stk	GB00B0V3WQ75	1.25	22 Nov 2017	8 mths	103.685	-3.979
14 Mar 2017	UK Gilt Index-linked Stk	GB0009081828	2.5	16 Apr 2020	3 yrs 1 mth	372.46	-3.056
14 Mar 2017	UK Gilt Index-linked Stk	GB00B1Z5HQ14	1.875	22 Nov 2022	5 yrs 8 mths	127.03	-2.515
14 Mar 2017	UK Gilt Index-linked Stk	GB00B85SFQ54	0.125	22 Mar 2024	7 yrs	117.5	-2.17
14 Mar 2017	UK Gilt Index-linked Stk	GB0008983024	2.5	17 Jul 2024	7 yrs 4 mths	367.968	-2.172
14 Mar 2017	UK Gilt Index-linked Stk	GB00B128DH60	1.25	22 Nov 2027	10 yrs 8 mths	136.95	-1.859
14 Mar 2017	UK Gilt Index-linked Stk	GB00B3Y1JG82	0.125	22 Mar 2029	12 yrs	125.645	-1.779
14 Mar 2017	UK Gilt Index-linked Stk	GB0008932666	4.125	22 Jul 2030	13 yrs 4 mths	369.173	-1.84
14 Mar 2017	UK Gilt Index-linked Stk	GB00B3D4VD98	1.25	22 Nov 2032	15 yrs 8 mths	193.633	-1.601
14 Mar 2017	UK Gilt Index-linked Stk	GB00B46CGH68	0.75	22 Mar 2034	17 yrs	148.21	-1.684
14 Mar 2017	UK Gilt Index-linked Stk	GB0031790826	2.0	26 Jan 2035	17 yrs 10 mths	267.75	-1.708
14 Mar 2017	UK Gilt Index-linked Stk	GB00B1L6W962	1.125	22 Nov 2037	20 yrs 8 mths	169.505	-1.673
14 Mar 2017	UK Gilt Index-linked Stk	GB00B3LZBF68	0.625	22 Mar 2040	23 yrs	164.24	-1.656
14 Mar 2017	UK Gilt Index-linked Stk	GB00B3MYD345	0.625	22 Nov 2042	25 yrs 8 mths	172.805	-1.642
14 Mar 2017	UK Gilt Index-linked Stk	GB00B7RN0G65	0.125	22 Mar 2044	27 yrs	158.642	-1.601
14 Mar 2017	UK Gilt Index-linked Stk	GB00B24FFM16	0.75	22 Nov 2047	30 yrs 8 mths	193.633	-1.601
14 Mar 2017	UK Gilt Index-linked Stk	GB00B421JZ66	0.5	22 Mar 2050	33 yrs	191.843	-1.6
14 Mar 2017	UK Gilt Index-linked Stk	GB00B73ZYW09	0.25	22 Mar 2052	35 yrs	187.795	-1.607
14 Mar 2017	UK Gilt Index-linked Stk	GB00B0CNHZ09	1.25	22 Nov 2055	38 yrs 8 mths	253.825	-1.604

Inflation Proof Returns on Cash

- Current deposit cash interest rates continue to be at an all time low at circa 1%
- Inflation as measured by CPI (Consumer Price Index) soon to be replaced by CPIH is 1.8% for the 12 months from 1st February 2016 to 1st February 2017
- Therefore the risk free rate if the claimant left their award in cash would be -0.8% not factoring income tax into the equation.
- Not at all dissimilar to the proposed rate.

The New Consultation

- So ‘How Long’ will this next phase take…..
- Consultation begins 30th March 2017
- Consultation responses to be submitted by 11.45pm on 11th May 2017
- Change in methodology would represent a fundamental change in the law. Couldn’t be implemented by a Statutory Instrument which could take 6 – 12 months as would have to pass through parliament. Impossible to predict.
- Clearly seems to be some appetite from the LC to consider changing the approach
- Clear that the political pressure is upwards only
- Government however has its hands full with other pressing issues……

The Defendant's Argument.

- No-one has ever invested solely in index linked gilts.
- This is true for a number of reasons.
    1. An individual simply can not purchase them in the 'Primary Market'. They are issued by the Debt Management Office for auction in 'sealed bids'.
    2. ILGS can be bought via a fund on the secondary market but individual will be exposed to price flutuations.
    3. The timeframe for holding until redemption would not fit with an individuals cash flow requirement. Therefore investors would be exposed to price fluctuation if needing access to funds outside of maturity dates (Liquidity Risk)
    4. No-one would invest in a product where a guaranteed loss would be certain from day 1.

Alternative Methods of Calculation

- The Original Consultation in 2012 was launched to deal with this issue.
- Should it be linked to actual returns achieved by investors and if so what assumptions might there be:-

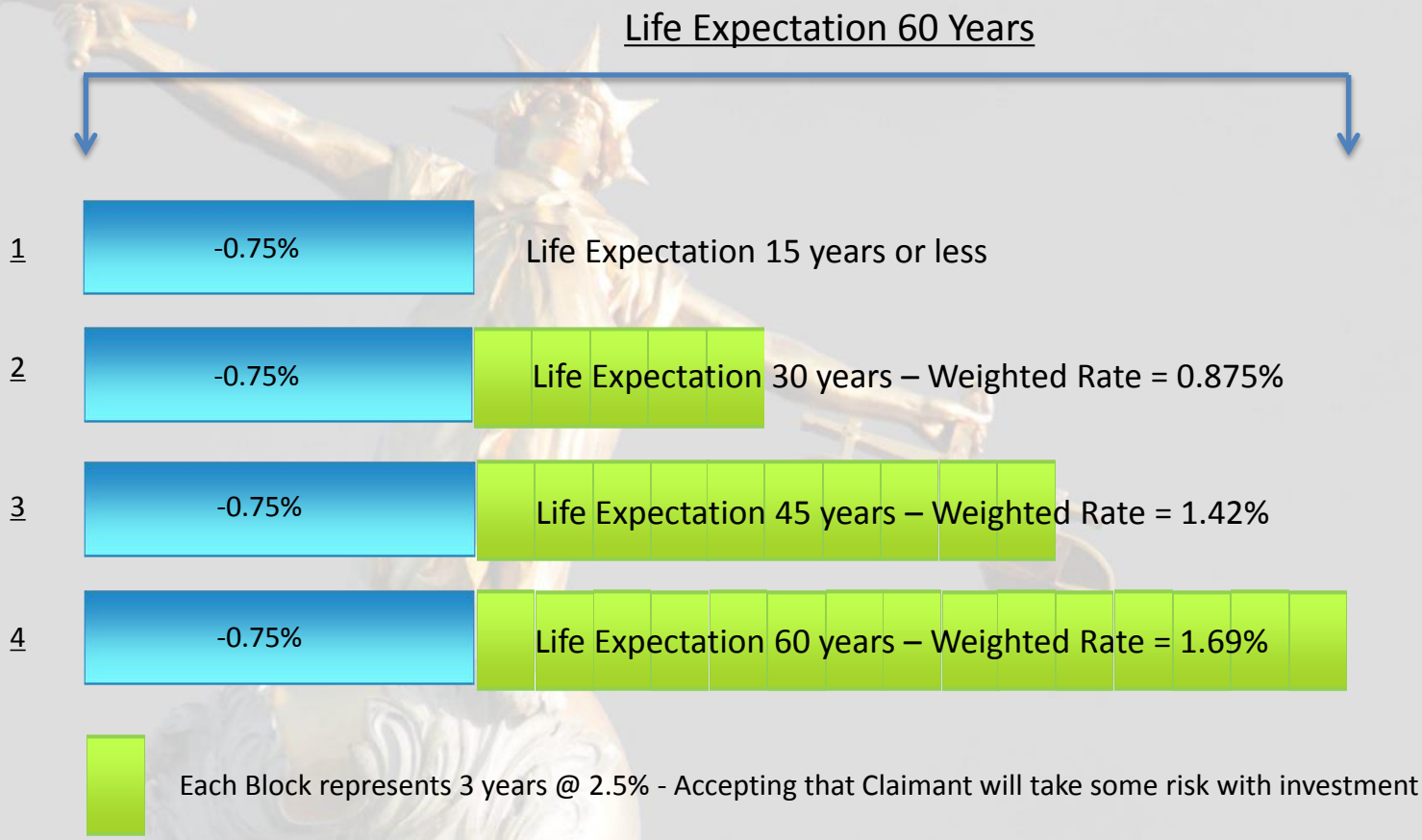
    1. A notional risk free rate
    2. A rate based on a heavy GILT weighted portfolio
    3. Return based on a risk seeking investor.

- The reality of the situation is that all claimants look to maximise their award of damages by investing to a greater or lesser degree.

Alternative Methods of Calculation

- If a basket of investment products is the preferred method of calculation this leaves open the question of variable discount rates according to age/life expectation.
    - A 70 year old claimant with 15 years L/E wouldn't take the same investment risk as a 25 year old with 65 years of L/E.
- Other countries and jurisdictions apply different approaches.
- Shorter term have a negative or zero rate with risk built into the longer term losses

Alternative Methods of Calculation



Alternative Methods of Calculation

Life/Exp In years	Weighted Rate %	Rounded to 0.25%
15	-0.75	-0.75
20	0.06	0.00
25	0.55	0.50
30	0.88	1.00
35	1.11	1.00
40	1.28	1.25
45	1.42	1.50
50	1.53	1.50
55	1.61	1.50
60	1.69	1.75
65	1.75	1.75
70	1.80	1.75
75	1.85	1.75
80	1.89	2.00

- Problems associated with this approach include:-
- Whose Life Expectation evidence to apply
- Accepted that risk is now required therefore need to claim Investment Management Charges
- £1.0m managed for 24 year old until life expectation at age 89, drawn down at a rate of £16k per annum until £0.00 balance would absorb £456,182.00 in investment management fee's.
- 'Eagles v Chambers' simply can't be applicable
- Complicated for the Courts and left open for challenge in many cases

The ‘Knock-on’ Effects of the Discount Rate

- **Table 27** has been renamed ‘Enhancement for Early Receipt’ as opposed to ‘Discount for Early Receipt’ – Does that feel right?
  - Pension Loss lump sum in the future (35 years) projected to be worth £60,000.00, discounted for early receipt at a rate of 0.4214 @ 2.5% = £25,284.00
  - Now table 27 gives us an enhancement factor of 1.3015 and therefore a sum of £78,090.00, 3 x as much.
  - If this was invested and a conservative 2% return achieved the lump sum would be worth £156,171.00 in 35 years time.
  - £78,090 x 1.02^35= £156,171.00

- **Huge Uncertainty** has been introduced into the legal process
  - If insurers believe that there will be a change quite quickly they will undoubtedly deploy ‘delaying tactics’.
  - Claimants need to be aware of these delaying tactics.
  - Might be in best interest to settle cases quickly.

The ‘Knock-on’ Effects of the Discount Rate

- **Cost Budgeting** will now have to be revisited in light of the change of the rate. Ensure that you get your budget revised: Para 7.6 PD3E before the work is done if you want to get paid.

- **Roberts v Johnstone** probably causes the biggest issue for claimants with a negative discount rate.
  - It clearly can not be right that it would be cheaper not to claim a head of damage than to claim for it.
  - General Damages (PS in particular loss of Amenity) should not have to be raided and in some cases depleted to cover other expenses.
  - If the calculation was predicated on the basis that the claimant would not have the ability to use the part of the award for investments when utilising the same fund for a property purchase, is it not sensible given that the assumption is that the investments would now lose money every year not to award the damages? Clearly not…….there is always going to be a cost associated with ‘Housing’

The ‘Knock-on’ Effects of the Discount Rate

- The solution may well lie in the Jurisprudence of ‘George v Pinnock’
  - In GEORGE v. PINNOCK, Orr LJ held that there was no difference between the loss of income on capital tied up in the property and the “annual mortgage interest which would have been payable if capital to buy the bungalow had not been available”.
  - In ROBERTS v. JOHNSTONE, the Court of Appeal’s task was to determine the appropriate rate for a GEORGE v. PINNOCK calculation.

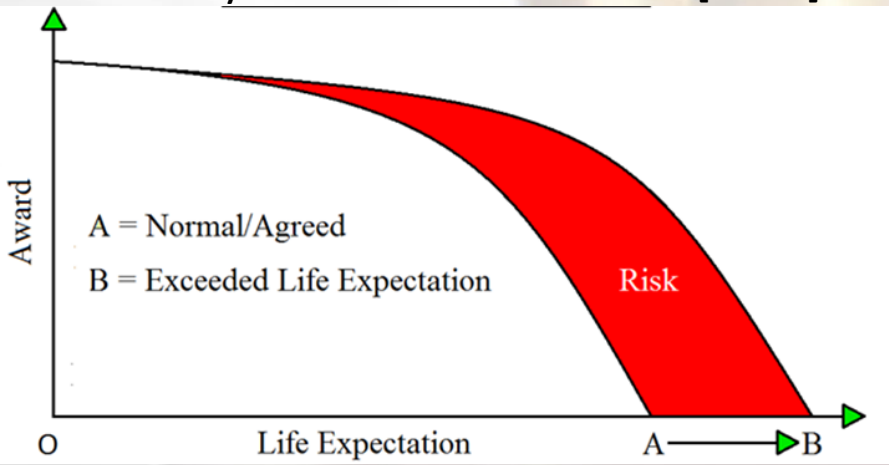
- A mortgage on the required property could be a solution.
- Who provides mortgages on a ‘Interest Only’ basis, particularly where you have protected parties and they have their property and affairs managed by a Trust Corporation?
- Do the Defendants purchase the property for the benefit of the claimant and have a Discretionary Will Trust drafted to return the asset to them on the death of the individual? Clearly this isn’t feasible for a whole host of reasons!
- Unfortunately there doesn’t seem to be an eloquent answer to this problem.
- IP applications may well have to be even more mindful to ‘Eeles v Cobham’ principles now.

CPR 41/21 and the Position of the Court

- CPR 41/21 and the Position of the Court remains the same.
- The responsibility of the Court is to ensure 'Fair and Adequate' compensation to the Claimant for the injuries suffered. Their function is not to ensure that an individuals damages have been 'Maximised'
- We find ourselves literally in an alternative Universe where the Defendants now want to offer PPO's and the appetite to accept lump sum settlements by the Claimants is much greater.
- Previously Defendants approach was to resist PPO's wherever and whenever they could, threatening the Claimants with cost implications if they didn't settle on a lump sum basis and wanted to pursue PPO's.

Periodical Payments Orders

- Rules do not suggest anywhere that the claimants preference is determinative and PPO's can be imposed by the Court where they feel it is more appropriate:-
  - Goldbald v Mamhood [2005]
  - Taylor v Chesworth & MIB [2007]



- The most appropriate method to avoid 'Over or Under Compensation' is by way of Periodical Payments. This approach completely removes the discount rate argument and is 'Fair' to both injured party and Insurer.

- We may find Defendants threatening with Cost implications if PPO's not accepted!!!

Periodical Payments Orders

- The introduction of a negative discount rate also hasn't negated the necessity for the Claimant to take some Investment Risk with their full award.

- Claimant Male age 24. Life expectation Normal to age 89. Care Costs £35,000 per annum

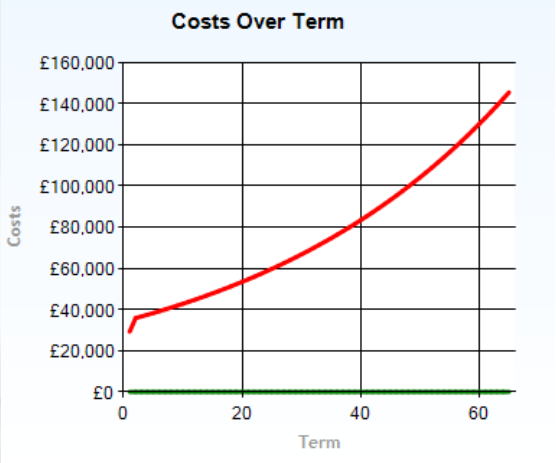
- Multiplier now on new rates = 81.00. Therefore capitalised Lump sum = £2,835,000.00

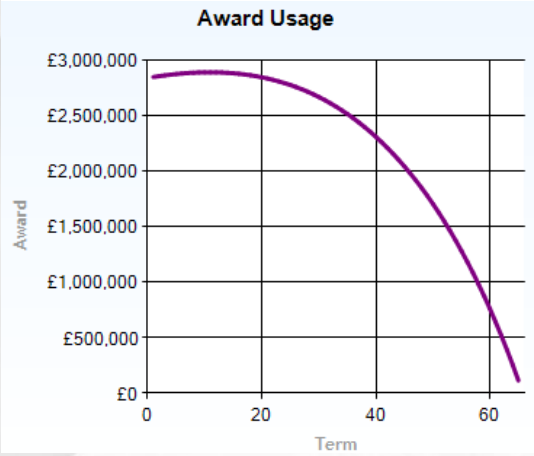
- If he does nothing with the money (tax neutral) and spends £35,000.00 per annum indexed at the average increase rate for ASHE 80th Percentile (2.25%) then the funds are exhausted after 47 years i.e. 18 years early, therefore investment returns are still required and risk necessary to replicate the PPO offering.

- The existence of contributory negligence in a case is made more complicated now as the PPO may well prove to be the better option with the shortfall in Care/Case Management/other significant future losses being accommodated by the inflated residual lump sum.

Client's Current Age	24
Expectancy	89
Lump Sum (leave blank for auto-calc)	2835000
Target Lump Sum	0
Start Date	07/03/2017
Lump Split (Income, Capital) %	40.00
	60.00
Growth Rates (Income, Capital) %	2.75
	2.75
Investment Charges (Income, Capital) %	0.75
	0.75

Personal Allowance	11,000.00
Higher Rate Tax Band	32,000.01
Additional Rate Tax Band	150,000.01
Tax On Basic Rate %	20.0
Tax On Higher Rate %	40.0
Tax On Additional Rate %	45.00
CGT Basic Rate %	18.00
CGT Standard Rate %	28.00
CGT Exemption	11100





The required term is 65 years. The proposed award will run for a term of 65 years
At the end of the projected term, the remaining balance is: £112,865.15

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Questions ?

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Thank you

for listening

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