Setting the Personal Injury Discount rate

(1) The process and the reasons

(2) Impact on Claims strategy

A Review by the Finance and Socio-Economic subject matter group, part of BLM's Catastrophic Injury Practice Group.

Setting the Personal Injury Discount Rate

Foreword by Andrew Hibbert, Partner and Head of BLM's Catastrophic Injury Practice Group.

At the time of our Newsflash on 15 July, communicating the discount rate of minus 0.25% to be applied from the 5 August, the Lord Chancellor's (LC) reasons for setting the rate at that level had not been released. Since then not only have they become available in a Statement of Reasons, but so has the advice from the Government Actuary (GA), an Impact Assessment and a summary of the responses to the call for evidence. You can find links to all this material in this document.

We have been considering the released material and our views and analysis are included within this review document which I hope you will find useful as a summary and commentary on the materials' contents.

The document is in two parts.

- In part 1 we provide our commentary on the Lord Chancellors reasons and approach, the advice he received whilst also drawing on the other documents
- In part 2 we look at what the decision means for claims cost and strategy.

Below are the members of the group involved in this work. The group has the title of the "Finance and Socio-Economic" group, one of our focus groups that aim to monitor subject areas of importance to catastrophic injury claims and our clients and which deals with a wide range of financial, statistical and demographic issues that impact claims and costs.

If you wish to discuss any aspects raised in this document please contact any member of the group or your usual BLM contact.

Finance and Socio-Economic Group members

- Mike Dobson – mike.dobson@blmlaw.com 0121 633 6638
- Alexandra Payne – alexandra.payne@blmlaw.com 0161 838 6852
- Ed Smethurst – edward.smethurst@blmlaw.com 0161 838 6905
- Stuart Hardy – stuart.hardy@blmlaw.com 0161 838 3936
- Sally Whalley – sally.whalley@blmlaw.com 0161 838 6896
- Andrew Williamson – andrew.williamson@blmlaw.com023 8038 2633

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Part 1 – The Process and the reasons

Introduction

On 15 July the Lord Chancellor set the discount rate under s. 1 of the Damages Act 1996 at (minus) -0.25%. This was the culmination of a process and approach introduced by the Civil Liability Act (CLA) 2018. Through statutory instrument (accessible here) the rate will apply from 5 August 2019.

The positive movement of 0.5% from the existing rate of -0.75% was estimated by the government to reduce claimant's compensation payments (or produce savings for defendants) of £80m pa. for the NHS and between £230m to £320m pa. for insurers[1].

Notwithstanding that, the rate has been greeted with dismay by insurers, and the insurers' trade body, the ABI. The concept of "savings" has to be set against the reality that cases had been settling at presumed rates much higher than the -0.75%, though it must be recognised that was a product of the uncertainty pending the outcome of the CLA new process and so would have ended with the publication of the rate. Disappointment may have been heightened by expectations, and the rumour mill, that a significantly more positive rate was in the offing. If it is of any comfort, and validates a view that the change in approach to assessing the rate under CLA was a significant step forward for defendants, it is pointed out that reassessing the rate on the pre-CLA basis would now require a move from -0.75% to "minus 1.5% or even lower". [2]

Insurers (unless there is to be any action against the decision) will now need to focus on (1) claims strategy to continue to minimise the cost of claims and (2) the obligations to report on the effect of the changes brought in by the CLA and how the reduction in claims costs are being passed on to premium payers. The latter requirement introduced by Part 3 of the CLA[3] will require insurers to maintain a record of claims settlements both at the new and how they would have been settled at the previous rate (a "counterfactual" is the term used in CLA)

The announcement was accompanied by a number of documents essential to understanding the approach taken by the Government Actuary and Lord Chancellor. This note draws on that wider information. This review, the first, was unique in that further reviews will involve the "experts panel".

The documents issued were:

1. Lord Chancellor's written statement to the House of Commons (link)
2. The Lord Chancellor's statement of reasons (link)
3. The advice to the Lord Chancellor given by the "GA" (GA) (link)
4. A summary of the responses to the Call for Evidence (link)
5. An Impact Assessment (link)

Also relevant to 3 was the earlier Technical Memorandum (link) from "GA"'s Department setting out a proposed methodology.

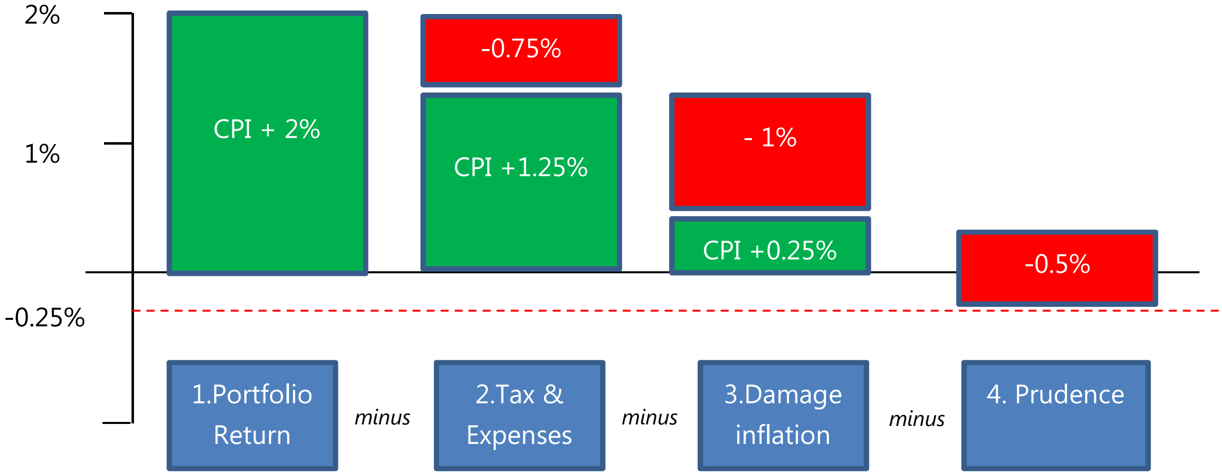
[1] See Impact Assessment
[2] See Impact Assessment Summary – the statement perhaps setting a comfortable context for the new rate though also reflecting reality around ILGS yields.
[3] Finalised secondary legislation is currently awaited following a consultation on draft regulations.

The documents present a significant amount of information (and several hundred pages) and this note only aims to cover the main themes.

The responses to the call for evidence closing at the start of the year, showed little consensus and in respect of many questions, little detail. Evidence from claimant representatives as to how claimants actually invested was surprisingly scant.

The mathematics

The mathematical steps to the new rate are easily understood and set out clearly in the Statement of Reasons:



The Statement of Reasons draws on the GA's advice save for step 4. The "GA" was asked to express views on matters like portfolio return and inflation by reference to the Consumer Price Index (CPI) of inflation e.g. "CPI + X %. The text below links to the blue boxes above. More information about each step is provided later:

1. The CLA sets down a new test for the claimant investor status. The question that begs is what type of portfolios should be assumed to be used by a claimant of that status. The representative low risk portfolio was assessed by the "GA" of **CPI plus 2 % pa**.
2. A claimant would incur charges in connection with the investment (and achieving the return of CPI + 2%). An allowance had to be made for those charges and the effect of tax. This the "GA" assessed at 0.75%. That reduced the real rate of return to **CPI + 1.25%**
3. Account had to be taken of inflation and in particular the inflation of costs or losses that the damages were intended to cover. This the "GA" assessed at CPI + 1%, which would need to be reflected in the real rate of return, reducing the discount rate to **CPI + 2.5%**
4. At this point, the discount rate would have been positive 0.25%. In what might be a controversial final step the Lord Chancellor applied a further reduction of 0.5% for "further

prudence". That produced a rate of **CPI -0.25%,** in effect the statutory rate of -0.25% after inflation, tax and expenses.

The size of the "prudence margin just happens to be at the same level as the "further margin", one of two standard adjustments to be made when calculating the discount rate, in Scotland. Para 20 of the Lord Chancellor's statement of reasons states:

> 20. I note that, on the baseline assumptions, at a rate of minus 0.25%, the representative claimant as modelled by the "GA" has approximately **a two-thirds chance of receiving full compensation and a 78% chance of receiving at least 90% compensation.** Such a claimant is approximately **twice as likely to be overcompensated as under-compensated** and is approximately four times as likely to receive at least 90% compensation as they are to be under-compensated by more than 10%. I consider that this leaves a reasonable additional margin of prudence which reflects the sensitivities of the rate to the baseline assumptions

It seems the adoption of the rate was with the intent of minimising the risk of under-compensation by moving away from a 50/50 under compensation/over compensation balance, to one where the probability of overcompensation was much higher.

Although initial responses to the continuing negative rate were along the lines that it perpetuates the fiction that claimants invest in loss making investments, the reality is that the baseline is a portfolio assumed to be used which generates returns 2% higher than CPI inflation. It is the application of the 0.5% "prudence" margin after deduction of inflation and charges that has the effect of producing the negative rate.

GA methodology

The advice to the Lord Chancellor runs to 77 pages. What follows aims to be a high level summary but we believe contains the salient points.

The references to the chances of receiving full compensation or of achieving 90% compensation need to be considered in the context of the GA methodology. This was set out in the Technical Memorandum and also the advice to the Lord Chancellor.

The fundamental approach was to focus on claimant "outcomes" i.e. whether or not a claimant has sufficient funds to meet assessed needs. This consideration is affected by many variables such as investment strategy adopted by the claimant, how much money the claimant has, and how the damages might be called upon to meet needs. There are so many variations that a "representative claimant" (see later) in terms of loss period, available funds and cash flow needs was modelled. In addition sensitivity analysis considered variations around the representative claimant assumptions.

Whether or not a discount rate will achieve the "outcomes" depends on the assumptions as to investment returns available in the future which in turn relies on modelling how economic factors affect future investment returns and rates of inflation. Two "Economic Scenario Generators" were used to produce 2,000 simulations of the effect of different economic scenarios. This provided a probability of the claimant having "sufficient funds" i.e. the number of scenarios out of the total in which the simulation produced a situation in which returns and inflation meant the claimant would be able to meet all needs. It was also possible to estimate when a claimant would have insufficient funds either within 10% of what was needed, or more than 10% less than was needed. Similarly, scenarios could be identified where the claimant would be overcompensated but by less than 10%, as well as when he overcompensation would exceed 10%.

The GA's advice contains a number of graphs showing the outcomes of the scenario modelling at different discount rates, but the simple table below is helpful:

	PI Discount rate			
	CPI – 1%	CPI-0.5%	CPI + 0%	CPI = 0.5%
Higher level of under-compensation (>10%)	10%	17%	28%	41%
Lower levels of under-compensation (<10%)	6%	10%	14%	16%
Sufficient compensation	84%	73%	59%	43%

To illustrate – at discount rate of – 0.5% (CPI- 0.5%) the simulations indicate the claimant would have sufficient funds in 73% of the scenarios modelled, and in 83% would have sufficient compensation or only under-compensated by less than 10% of needs (73% + 10%). There was only a 17% chance that the claimant would be undercompensated more than 10%.

The immediate impression from this table (and much of the content of the advice) is that "sufficient compensation" encompasses both situations where the claimant is overcompensated by no more than 10% <u>as well as</u> where overcompensated by more than 10%. However, by combining both those outcomes into one measure it prevents the extent of overcompensation being appreciated. The approach seems to be that over compensation is acceptable, as it means the claimant has sufficient funds (even if in surplus). Indeed, the GA defines "sufficient compensation"[4] as "the proportion of simulated scenarios in which the claimant has <u>more than</u> sufficient funds to meet their needs".

At this point it is worth considering the "policy objectives and the intended effects" for CLA 2018 set out in the Impact Assessment:

> "The policy objective for introducing the reforms in the Civil Liability Act 2018 was to set the PIDR at a level which ensures that claimants' expected financial needs are met and avoids a significant risk of significant under-compensation while reducing the overall amount of over-compensation previously received by claimants"

The policy statement seems to support a skew in the claimant's favour given the intention to avoid significant risk of significant under-compensation (seemingly now assessed at the 10% level) and only reducing over compensation.

This does seem to be a departure from the "no more no less" approach to the 100% compensation principle. The aim should not be to deliver "more than" is needed.

If we go back to the statement of reasons, the Lord Chancellor acknowledges (para. 15) that a discount rate of + 0.25% (prior to the application of "prudence") results in a 50/50 chance of claimants being under or over-compensated. A multiplier approach inevitably means some claimants will actually need more or less than is awarded (in particular if they live longer or shorter than the period to which the multiplier was set), is well known and one of the reasons why periodical payment orders

[4] Page 18 Advice

exist to avoid that risk. So, a rate that creates a 50/50 chance of under or over compensation seems to reflect that, and is also fair to both claimants and defendants.

Nevertheless, the Lord Chancellor felt 50/50 was "too high a risk" of under-compensation, and the same applied to a rate of 0% where there the claimant "would have approximately a 60% chance of receiving full compensation" (although reading the report, the data in the GA's advice appears to indicate that 60% chance includes something like 50% chance of being over compensated by more than 10%).

In fact, the only time over-compensation is mentioned as unacceptable (para. 21) is in the context of a – 0.5% where it is said that a 70% of chance that the award would not be exhausted by the end of the loss period (over compensation) was too high, though that is likely to be only a few percentage points different to -0.25%. We say 'likely' (and by interpolation), as one frustrating feature of the advice is that although the LC opted for minus 0.25% and refers to the chance of receiving full compensation at that rate, minus 0.25% does not feature in the text or data in the GA's advice. The source of the statements in the statement of reasons is not clear. However, based on those the LC has opted for a discount rate which produces 66% chance of over compensation, a substantial part of which will be higher than 10%, and where the chance of over-compensation is twice that of being under-compensated.

The "representative claimant" basis for modelling

The GA identified key variables in the analysis as:

- Claimant characteristics: purpose for, and time period over which a claimant invests
- Investment portfolio: level of risk adopted by claimants and the associated return profile
- Expenses and tax: levels incurred over the term of the investment
- "Damage inflation": rate at which a claimant's costs are expected to rise over time

For each of these the GA had to "fix" values to conduct the analysis, although sensitivity analysis was adopted with additional values. In reaching the "fixed" values the GA called on the responses to the call for evidence where they provided assistance, (which was not always).

Claimant characteristics

The assumption was that the claimant would invest for 43 years. This was based on the middle or responses to the call for evidence which put the average duration of losses for personal injury cases of between 40 and 45 years. However, as the GA's terms of reference required consideration of both short and long term investments, he also considered 10 years and 50 years.

The investment portfolio.

Exercising many minds has been the question of what type and composition of investment portfolio would meet the new test under the CLA i.e. an approach which involves more risk than very low risk, but less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims. The GA was asked to advise on suitable diversified low-risk portfolios and again the call for evidence responses were taken into account. He also considered reference portfolios in the market.

Those responses varied widely on the important point of allocation between "growth assets" (higher return/higher risk) and "matching assets" (less return/less risk), with responses varying between 30% and 55% for "growth". The GA averaged the responses at 42.5% allocation to growth assets which, in his opinion, reflected a low risk portfolio in accordance with CLA's requirements.

In terms of asset allocation, for the less risky/lower "matching" part of the portfolio the evidence, the GA said, suggests 10% to 30% in cash and the rest in bonds of which 60% should be in Gilts and the 40% in corporate bonds.

There was a much wider spread of opinion around the riskier "growth" area. However he derived three low risk portfolios illustrative of the range of portfolios in which a low risk investor, as outlined in CLA, might invest[5] :

Allocation	Cautious	Central	Less-cautious
Lower risk/Matching	70%	57.5%	45%
Cash	12.5%	10.0%	7.5%
Gilts	35.0%	30.0%	22.5%
Corporate bonds	22.5%	17.5%	15.0%
Higher risk/Growth	30%	42.5%	55%
Equities	22.5%	32.5%	42.5%
Alternatives	7.5%	10.0%	12.5%

Expected returns on these portfolios were calculated using 2,000 random simulations of future investment incomes.

His estimate for the median rate of return for the representative claimant (43 years investment) was CPI + 2%. This was, in his view, an appropriate starting point for considering the discount rate subject to inflation and tax and expenses.

The analysis also looked at shorter periods (10 years) and longer periods (50 years) and identified a difference of between 1% and 1.5% between a claimant investing for 10 years and one investing for 50 years.

Tax and expenses

Whilst acknowledging that the question of tax would be unique to each claimant, the GA formed the view that a reasonable adjustment for tax would be in the region of 0% to 0.5%. This was based on a number of scenarios involving receipt of three levels of awards: £100k; £1m and £3m and an illustrative investment strategy. There was a recommendation that this rate was kept under review, for if the economic environment returns to "normal", with higher interest rates, a higher adjustment would be needed. There is no indication of whether that would spark an interim review of the rate or a matter to wait until the next full review under CLA.

Costs associated with investment management, expenses and advice would differ dependent on the investment strategy adopted. Responses to the call for evidence varied widely (from as little as 0.2% of the fund under management to 2%) and often depended on the view as to whether passive or active

[5] Which are different in composition to that of the "Notional investment portfolio" built into the Scottish legislation: Damages (Investment Returns and Periodical Payments (Scotland) Bill

fund management was needed. The CLA test of a "properly advised claimant" suggested a more frequent and involved activity, albeit still passive, and he assessed the costs as between 0.25% and 0.5%.

The GA identified expenses groupings as (1) financial adviser fees; (2) fund management fees and (3) other associated costs e.g. platform fees and transaction charges.

It is perhaps worth reflecting here, that the cost of "expenses" as defined in the 3 components shown below, having been reflected in the discount rate there should not be any attempt by claimants to recover them as heads of loss in schedules, as has happened in the past. For this reason the allocations are shown.

1. Financial adviser fees – these included initial investment advice based on the assessment of the claimant's objectives and risk profile; regular reviews and portfolio monitoring. Responses to the call for evidence were around 0.5% pa, but the GA was inclined to include an allowance slightly below that for a passively managed fund
2. Fund management – fees to cover administrative expenses were placed between 0.2% and 1% in the call for evidence responses, but taking into account other sources of information the GA assessed an allowance at 0.25% to 0.5% pa
3. Other associated costs – these included access and administration e.g. custodian or platform fees, buying/selling, commission and dealing costs. The evidence was that these were in the region of 0.15% pa but could be much lower and an allowance of 0.1% to 0.2% pa was included

In the result, and taking into account the components and range of reasonable allowances it was concluded that claimants would incur expenses and tax charges between 0.6% and 1.7% pa of the fund under management. The GA felt it appropriate to make an allowance of 0.75% for expenses and tax.[6]

Damages inflation

For many years claimants have complained that multipliers that reflect RPI/Price inflation are inadequate where underlying losses inflate in accordance with earnings inflation. The adoption of alternative indices (e.g. Ashe indices) in the context of PPOs resolved that issue in the claimant's favour, but multipliers have continued to reflect RPI inflation (expressly, or implicitly under ILGS) against all attempts for claimants to raise the issue in a series of cases.

The terms of reference for the GA required him to adopt CPI in preference to RPI. CPI is a price index. The GA suggests that costs such as those for nursing or care would inflate in line with future earnings growth which he would expect to be around CPI + 2% pa. over the long term (and drawing on data back to 1970), whereas others would be linked directly to CPI. The effect of damages inflation would be to reduce the net rate of return (see earlier section on the mathematics).

[6] A further similarity to the approach in Scotland

The responses to the call for evidence did not produce evidence on damage inflation[7] to which claimants were subject but opinions were offered. These did not produce a consensus of views on how costs to be met by damages actually inflate[8].

The GA acknowledged there would be a mixture of price and earnings inflation impacting losses and costs, and in the absence of firm evidence he adopted an inflation level of CPI + 1 % pa. This inflation assumption feeds into the calculation of the net or real rate of return.

It is clear from this approach that whereas multipliers were linked to assumed RPI "price" inflation, we now have a position where they are linked to inflation somewhere between the preferred prices index of CPI and an assumed earnings inflation of CPI + 2%. In short we have moved to a new basis seemingly compromising both earnings inflation and price inflation. That said, the GA said he would expect RPI to fall between CPI and earnings inflation, so perhaps more a change of approach but neutral in cost terms, but impossible to be sure this is not a further subtle change.

Claimant characteristics – sensitivity analysis

The sections above provide summary form of the advice from the GA, accepted by the LC which led to

- An assumed loss/investment period of 43 years
- A portfolio producing a return of CPI + 2%
- Tax and expenses charges of 0.75%
- Damages inflation CPI + 1%

Additionally the GA reported the outcome of sensitivity analysis in which alternative values were considered for each of the four items above. The results of these tests were published in his advice. He cautioned against adopting an approach aggregating extremes of ranges and that it was unlikely that variations would, in the round, vary by more than 0.5% from his assessments and the ± 0.25% rate.

Dual discount rate

A section of the GA's advice was given over to considering an approach based on dual discount rates, that is, rates dependent on the loss period or period of investment. Although the effect of investing for longer and shorter periods was recognised when considering the single rate approach (particularly within the sensitivity analysis), under the dual rate system more than one rate might apply to a single loss period. The Ontario model, an example of this approach, is well known – other examples are Jersey and Hong Kong, though in each case the approach is different.

In his statement of reasons the Lord Chancellor said it would not be appropriate to adopt a dual rate for this review as there was insufficient evidence but that it should be explored in more detail. A consultation would be started to inform the next discount review and the work of the expert panel advising him.

This would indicate that there is no prospect of a dual system developing anytime soon and with the next review required no later than 2024, and the expert panel formed as part of that, the possibility of a dual rate approach looks a long way off.

[7] Q 8 (page 20) summary of responses to the call for evidence

[8] Though data with regard to the composition of an award of damages and particularly the proportion of earnings related losses was given in response to Q5 (page 10) of the responses.

It is worth reflecting on some of what the GA had to say about it. Naturally the dual rate reflects that claimant's investing for shorter periods achieve lower returns and run greater risks (in that they are unable to make up for losses in the same way longer term investors can). A decision would be needed as to how the dual rate approach could operate in relation to the "switching point" that is the point in years at which one rate changes to another. Three possibilities were identified:

- Where the period of loss extends beyond the switching point all damages are discounted at the long term rate[9]
- All cash flows before the switching point are discounted at the short term rate; all cash flows beyond the switching point would be discounted at the long term rate
- Or a blended approach[10] where any loss period beyond the switching point would have cash flows discounted partly at the short term rate (for the period to the switching point) and partly (the period beyond) at the long term rate

The GA set out some advantages and disadvantages of a dual rate approach but also went on to recommend a switching point of 15 years, and a long term rate thereafter of CPI +1.5%. The selection of the short term rate, reflecting the adverse investment position of short term investments, also had to take into account the same probability of "sufficient compensation" applied in the context of a single rate. To achieve a position where there was a 60% likelihood that investment incomes would meet the claimant's needs a short term rate of CPI -1.25% was needed; to achieve 70%, then CPI – 1.75% was required. The 60% and 70% are above and below the 66% probability adopted by the Lord Chancellor when setting the single rate, but with the 70% being closer.

Although the dual rate approach is not being applied it is instructive to compare multipliers for set periods at the single rate and using the 70% probability short term rate of CPI – 1.75%, long term rate of CPI + 1.5% and a switching point of 15 years[11].

Table comparing life multipliers for single rate (-0.25%) and dual rate (-1.75/1.5) switching at 15yrs.		
Age	-0.25% single rate	15 years: -1.75%/1.5% - dual rate
20	73.56	43.81
30	60.83	41.54
40	48.76	36.53

There is, as can be seen, a very significant difference in the multipliers given the significant loss period beyond 15 years at the higher rate of + 1.5%. Generating a focus on a dual rate approach is clearly in defendant's interests but, reiterating the Lord Chancellor's comments, this seems a prospect only for the next review.

Future changes in economic outlook

There is an interesting section in the GA advice (9.23) in which he considers the impact on his simulations of changing economic assumptions. The GA says (underlining added):

9 As, now, in Jersey and where the switching point is 20 years

10 As in the Ontario model, and where the switching point is 15 years.

11 Not shown in the GA advice, prepared using the dual rate function in Pi calculator.

> "The PI discount rate adopted following this review is likely to be in force for the next five years until the next review. Under the assumptions in my modelling <u>a claimant settling towards the end of this five years would be expected to be investing in more favourable economic conditions than a claimant investing next year…</u>

(then at 9.27)

> To estimate the potential effect of this, I have repeated my analysis but with projections starting in five years' time. Broadly speaking, simulated returns calibrated to potential economic conditions in five years' time are around 0.5% to 1% higher than return simulations calibrated to December 2018…[9.28] <u>Assuming that claimants settle evenly throughout the next five years it might be possible to argue that the Pi discount rate should be set around 0.5% higher than outlined in my report</u>

The GA goes on to point out the risks to this more favourable viewpoint (Brexit, low productivity) and closes by saying

> "…the Act includes a provision for the Pi discount rate to be reviewed before the end of the five year review period and I believe that this is a better mechanism for the Government to review and update the PI discount rate should economic circumstances change materially"

The difficulty with that view, is that the rate used to assess a claimant's damages is fixed once and for all at the point of settlement; claimants settling under the new rate will still benefit from a discount rate which ignores those potential changes and better investment environments, as and when they occur, delivering higher returns and increasing the level of overcompensation already built into the Lord Chancellor's selection. The selection of the discount rate always used to take into account the longer term view of investment cycles (as the GA does when look at sensitivity analysis or the dual rate), but there is a feeling that there has not been a recognition that reliance on the next review (rather than now) will not change the basis of awards made before that time. Where the "representative claimant" has an assumed 43 year loss, and hence, investment period, the absence of any allowance for longer term performance risks more overcompensation.

The future process

Finally, in this section, it is worth reflecting on the future process under CLA. Unless reasons arise to do so earlier (which is possible) the rate must be reviewed within no later than five years. That would mean in 2024. There is provision for a review to be triggered earlier if circumstances so require. Under CLA it is uncharted territory as to what might trigger a review.

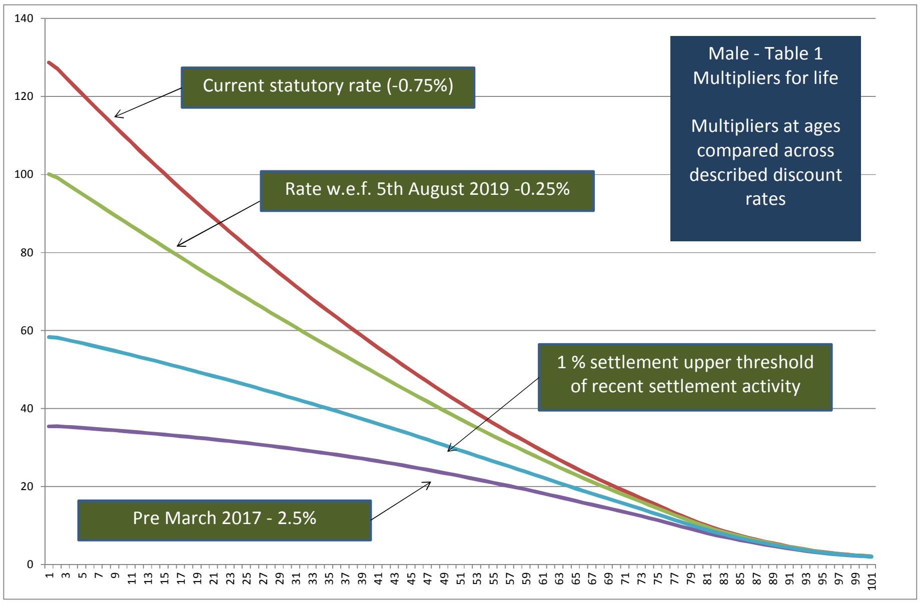
Part 2 - Impact on claims

A turbulent 30 months!

The position now is that the statutory discount rate under the Damages Act is minus 0.75%, but will change from the 5 August to minus 0.25%. Where the court is awarding damages from that date the rate to be taken into account will be minus 0.25%. The Government Actuary has yet to produce tables at that rate but tables are available by link from our newsflash on 15 July (here).

The court will follow the rate subject to any arguments which can be raised under s 1 (2) of the Damages Act that some other rate is more appropriate. Although arguments under s 1 (2) were possible in the context of the minus 0.75% rate, and whilst the review was taking place, now that the review has concluded and a new rate set, we will return to the previous position (and case law) making arguments under s 1(2) be difficult to succeed with for either party.

The chart below sets out a position which will be well known to all compensators and their representatives:– a 30 month period in which the rate, multipliers and the value of damages has varied significantly.



The graph shows multipliers on the vertical axis against age on the horizontal axis. From the pre March 2017 rate of + 2.5%, through the change to minus 0.75% and now minus 0.25% the widely varying multipliers particularly at younger ages can be appreciated. The 1% line is included for comparison as many will recognise that what has been agreed in settlements (and approved by the Court) since March 2017 has seldom reflected the statutory rate. Although parties seldom agreed a rate, (though there were instances of claimants pleading positive rates) rather a probably rate was deduced from the settlement amount and pre-negotiation valuations at different rates, there has been recognition that settlements have been in the region of 0.5% to 1% - the 1% line is a useful reference point. However, that period between rate reviews (in which the fog of uncertainty allowed these negotiated settlements) would always come to an end when the new process under CLA reached its conclusion. The statutory rates are now minus 0.75% or minus 0.25% based on the relevant date when damages fall to be awarded. Two points about the "date":

- That date is the date that judgment is handed down, so any cases "in the pipeline" but where judgment is handed down after 5th August should be subject to the new rate
- When acting as a court of approval the court is not bound to follow the rate under the Damages Act (as opposed to when awarding damages) as the court's function is different (approving a settlement on the "best interests" basis). However, one must expect:
    - any settlements negotiated on behalf of protected parties and which reflected (during the uncertain period) a rate higher than minus 0.25% may be pulled from approval and the claimant seeking a renegotiated figure. This reflects that there is no concluded settlement in a protected party case until approval is obtained
    - Should it be the case that a defendant agreed a settlement subject to approval at a rate lower than minus 0.25% (perhaps the existing statutory rate) then prior to approval the option is there to open up the settlement to renegotiate at the current rate

The impact on the level of damages

The Impact assessment stated at para 62:

> We estimate that the increase in the discount rate from -0.75% to -0.25% will bring **savings to insurers of between £230m to £300m pa and savings to public bodies (mainly the NHS) of £80m pa. ...** The above range provided tries to capture the existing uncertainty given the limitations of our data.

Of course, these are only savings to insurers if they have been paying at minus 0.75%

Following on from the graph of multipliers, below is an update of a table initially used in our communications following the earlier change to -0.75%. It includes the discount rates on the graph above but also includes an illustration of annual cost of £100,000 showing the saving between minus 0.75% and minus 0.25 and also the percentage change in multipliers at both rates. It also shows the notional additional cost (as a negative figure) between minus 0.25 and the recent settlement activity at c 1%.

Age	Life Expectancy	-0.75%	-0.25%	2.50%	1%	% reduction multiplier -0.75 v -0.25	Reduced £100k pa. -0.75% v -0.25	Increased £100k pa 1% v -0.25
5	83.89	118.67	93.73	34.90	56.29	21	£2,494,000	-£3,744,000
10	78.31	108.32	86.89	34.08	53.77	20	£2,143,000	-£3,312,000
20	67.22	88.96	73.56	32.09	48.35	17	£1,540,000	-£2,521,000
30	56.34	71.43	60.83	29.60	42.45	15	£1,060,000	-£1,838,000
40	45.76	55.66	48.76	26.52	36.11	12	£690,000	-£1,265,000
50	35.45	41.44	37.30	22.69	29.27	10	£414,000	-£803,000
60	25.92	29.2	26.95	18.29	22.36	8	£225,000	-£459,000
70	17.33	18.85	17.81	13.44	15.58	6	£104,000	-£223,000

Offers and Part 36 offers

The most obvious effects of the new rate coming into force are that:

- An offer made at -0.75% is now going to be too high
- An offer made reflecting the settlement approach prior to the review outcome (probably much higher than -0.75% to the extent of being positive) is now going to be too low

For defendants, the most immediate task is to identify any claimant offers which fall into the second category. They are likely to be withdrawn or revised very quickly and possibly, by now, that has taken place. If there are any they should be reviewed urgently as to whether they now represent a favourable settlement.

The wider issue for defendants is their own offers and how they now appear in terms of promoting settlement or providing costs protection. Accepting always, and in line with our earlier guidance, that offers reflect a great many issues not just the discount rate or multipliers, a judgment call is urgently needed on whether the offer nevertheless represents a compromise of all issues at a level the defendant remains happy provides protection, or whether adjustment is now needed if the case is going to fall for settlement/trial after the 5 August.

Annual heads of loss

General approach

In the wake of the change to minus 0.75%, our guidance in bulletins and seminars, was to tackle the higher multipliers by strategies that managed and challenged the annual loss to which the multiplier applied or to look at arguments which reduced the multiplier. This remains good practice in all situations but particularly whilst high levels of multipliers looks set to continue. An aspect of this is the need to monitor and cite technological advances in the years ahead in all areas of medicine and rehabilitation to firstly, promote better physical and mental outcomes but secondly where technology promotes independence and function and removes a lot of the expensive human input of delivering care and assistance.

Another important area is life expectancy and we provide an update on some recent developments in respect of that:

Life expectancy

A well-constructed argument around life expectancy can have a substantial impact on the multipliers applicable to damages calculation.

At the time of writing we await the most recent set of ONS Biennial life expectancy data, the 2018 set, due towards the end of the year. It will require recalculation of the multiplier tables, although differences caused by interim data sets (2010, 2012, 2014, 2016) have not been significant; parties tend to be content to work on the existing “Ogden tables” which remain based on the 2008 set.[12]

[12] We have asked the Government Actuary department whether the revised tables due shortly to include the new minus 0.25% rate will change the data set (2008) or projection year (2011) that the tables are currently based upon. At the time of writing a response is awaited.

There are suggestions that the 2018 set will show a slowing down or even reversal in the previous upward trend of life expectancy, the result of a number of lifestyle factors reducing expectations of future life expectancy.

For now, the tables provide general population life expectancy. In any case, being able to show that claimant life expectancy, and hence loss period, is reduced either for (1) non accident related conditions that existed prior to the accident or would have developed but for the accident and/or (2) the effects of the traumatic injuries (subject to the creation of a lost years claim), will directly impact the multiplier.[13]

Issue 1 above generally needs a thorough review of the claimant's pre-accident lifestyle and/or medical history. There have been a number of cases recently which claimant's may point to as preventing a defendant relying on general medical or physician medical/statistical evidence to suggest that the claimant is "atypical", in other words that any conditions do not fall within the range of conditions for which the averaged life expectancies underlying the Ogden tables are applicable. In fact the cases do not impact the defendant's position which remains that such evidence can be relied on but, as always, it has to be shown that there is a need and purpose for it.

In *Stephen Mays (a protected party) v Drive Force (UK) Ltd*[14]. the defendant was permitted to rely on such a report in the face of resistance from the claimant, the judge hearing the application making clear that such evidence had value where the co-morbid factors would impact life expectancy. In a subsequent case of *Carol Dodds (A protected party by her sister and litigation friend Janice Dodds) v Mohammad Arif & Aviva Insurance*[15], the defendant did not obtain permission. The Judge in that case set out a number of propositions which in reality do not conflict with "Mays" but amplify what was said in that case:

- Where the claimant's injury has not itself impacted upon life expectancy, permission for this category of evidence will not be given unless the condition in paragraph 5 of the Explanatory Notes[16] is satisfied, namely that there is "clear evidence ... to support the view that the individual is atypical and will enjoy longer or shorter expectation of life"
- Where the injury has impacted on life expectancy, or where the condition in paragraph 5 of the Explanatory Notes is satisfied, the "normal or primary route" for life expectancy evidence is the clinical experts
- The methodology which the experts adopt to assess the claimant's life expectancy is a matter for them
- Permission for "bespoke" life expectancy evidence from an expert in that field will not ordinarily be given unless the clinical experts cannot offer an opinion at all, or for reason state that they require specific input from a life expectancy expert, or where they deploy, or wish to deploy statistical material, but disagree on the correct approach to it.

[13] Current plans are to focus on this subject in the start of our second programme of Catastrophic Injury seminars in November.
[14] [2019] EWHC 5 (QB)
[15] [2019] EWHC 1512 (QB)
[16] To the Ogden tables

Rather than preventing the defendant from relying on this evidence the position is that there needs to be a reason for it, and if, after asking, the existing medical experts who are largely engaged with the accident injuries, are unable to deal with matters such as obesity, hypertension, cholesterol etc. all matters that can impact life expectancy, then the conditions for such evidence must exist. It will also be seen from proposition 1, that where there is no accident related life expectancy issue (i.e. it relates only to co-morbid conditions), the evidence itself may provide its own justification for admissibility.

Roberts v Johnston ("R v J")/Accommodation claims.

The case of *Swift v Carpenter*[17] is due to be heard in the Court of Appeal in the week commencing 22nd July 2019. The outcome of that appeal may fundamentally change the approach to accommodation claims – then again it may not!

As things stand the new rate is a negative one. Under the current "*R v J*" approach, the claimant would have no claim for the loss of investment income on money diverted to provide accommodation. That is because the negative rate means there is no investment income lost. All this is familiar from the case of *JR v Sheffield Teaching Hospitals*[18] ("JR") followed in *Swift*.

However, a further point to consider is that whilst the "*R v J*" annual loss rate was pegged to the discount rate by the House of Lords in *Wells v Wells*, that was on the basis that a risk free rate of return was appropriate for *R v J* and that was what an ILGS based discount rate provided. It was convenient, therefore, to use the same source for a risk free rate of return for both the multiplier and *R v J* i.e. the one stipulated under the Damages Act. Now that the new investor status under the Civil Liability Act, to be used when identifying the returns the claimant could achieve, has moved away from the risk free basis, it may be challenged as to whether there should continue to be any tie up between *R v J* and the statutory discount rate. It would, if anything, mean that a distinct rate for *R v J* based on risk free investments would be even lower (more negative), as a risk free portfolio by definition will deliver lower returns than a higher risk one. That would make the argument for the "no loss" approach in "JR" even stronger.

Interim payment applications

The comments around *R v J* inevitably follow on to interim payment applications and the strategy to adopt. Subject to the outcome in *Swift*, the continued "no loss" context for the capital cost calculation in the *R v J* approach will continue to cause difficulties for claimants in identifying sufficient sums to incorporate into the "Eeles phase 1" bucket. Nor does the new rate assist claimants with arguments that the size of the lump sum will prompt a trial judge to award a lump sum as opposed to a PPO, sometimes raised to increase the "phase 2" pot, as on paper the recoverable lump sum will now be lower. This will continue to provide a platform for collaborative handling, where reciprocated, as deals around interim payments, particularly if to house or rehabilitate, the claimant can have a wider benefit to handling the case.

[17] [2018] EWHC 2060 (QB)
[18] [2017] EWHC 1245 (QB)

Periodical Payment Orders

A component of the Government's consultations following the rate rise in March 2017 was the process for resolving cases through a combination of lump sums and periodic payments, as opposed to entirely by lump sum. A driver was the comparatively low take up of PPOs which seemed to run counter to the perceived benefits the claimant received from such an order (even when rates were 2.5%).

The intention was to consider a wide range of issues such as the advice given in connection with adoption of PPOs, and to also include consideration of how it could be made financially more attractive for insurers to offer PPOs (particularly in relation to holding capital against the future liability).

It had been heard that the PPO aspects of the consultation had been passed to the Civil Justice Council to take forward, but to date there are no signs of this having happened.

As it is, it is likely that the high multipliers derived from a continuing negative rate will disincline claimants from PPOs. That said, even at this level, claimants remain open to the risks that PPOs protect against (mortality, inflation, investment) and it is likely that where settlements are before the Court, a PPO will be considered in a claimants best interest unless there are convincing reasons not to take that view (often matters such as contributory negligence or unpredictability of needs). We will need to wait to see whether the propensity for PPOs changes as a result of certainty now over the rate.

Whilst the attraction of avoiding high multipliers can be seen to be an advantage of PPOs, they are only ever a partial solution given that few heads are paid periodically and it will be a balancing act for any insurer to consider the financial and capital issues attached to either approach