



We would welcome responses to the following questions set out in this consultation paper, either generally or specifically in relation to one or more of the jurisdictions in the United Kingdom. In providing your responses to these questions, it would be helpful if you could include any analysis or evidence you have to support your responses, drawing on experience of other sectors or countries as appropriate.

General issues

Question 1: do you agree that the general principles of:

- accuracy
• transparency and simplicity, and
• stability

should be used to assess the appropriateness of proposed solutions?

[] Yes [X] No

If not, please give reasons.

Please note that in order to provide some explanation to this response, it has been necessary to answer no. We note the description given to accuracy in the consultation. We agree that it is important to ensure that claimants receive full compensation for their losses; but, at the same time, there should not be over-compensation, which would be detrimental to defendants and consequently to other policyholders (in insured cases) or to taxpayers (in public cases). However, we believe that it would be more appropriate to describe this as "fairness". It is entirely possible to achieve accuracy in calculations without having any degree of fairness. Accuracy – we agree that it is important to ensure accuracy, as defined in the consultation, but note that for some awards the period over which costs should be met is very long and accuracy becomes spurious. If a move away from ILGs investment is to be considered, we note that claimants may opt for different investment strategies at different stages of their lifetimes, which makes the determination of expected returns more difficult. However, we also believe that actual investment strategies should not be taken into account in determining a market-consistent discount rate. It is important to note that other risks (e.g. longevity) may be of equal or greater significance than the discount rate. Transparency and simplicity – the Institute and Faculty of Actuaries (IFoA) agrees that the calculation of the rate should be transparent, which aids understanding for all parties. We also note that transparency does not always equate to simplicity. Complexity in the setting of the rate can be explained in a manner that leaves no doubt as to the approach taken. Stability – a degree of stability is desirable in order that claimants and defendants work with a level of certainty. There should not be second guessing as to how delaying, or speeding up, a settlement could influence the final outcome due to a potential change in the discount rate. However, the discount rate should reflect long term investment expectations, which means there should be periodic reviews of the discount rate. Stability should not be used as a reason not to change the rate, if market conditions have changed sufficiently to merit a review of the discount rate.

Question 2: do you agree that accuracy is the most important of these three general principles?

[] Yes [X] No

If not, please give reasons.

We note again our response to Question 1 that the definition of accuracy may be better termed as "fairness". Our understanding of what accuracy would normally mean is that accuracy could be spurious, especially in relation to the long periods over which costs should be met.

Question 3: are there any other issues relating to the setting of the discount rate and the possible encouragement of the use of periodical payments that you would wish to draw to our attention? Please give reasons.

In order to place our response in context, we refer to some recent work undertaken by the IFoA. The IFoA considered the requirements for setting an appropriate discount rate in the paper "A Framework for the use of Discount Rates in Actuarial Work". One of the main considerations in that paper is the purpose of the valuation. For the discount rate to be used to determine lump sum compensation the IFoA believes that this should be assessed using the matching approach of the IFoA's discount rate framework, i.e. on a market-consistent basis, which implies use of index-linked gilts as the risk-free matching asset. A market-consistent approach does not take into account the actual assets held, but relies on market information at the date of the transaction to determine the discount rate.

While the discount rate is important in determining the amount of any award, other risks should not be overlooked. In particular, longevity is an important factor especially for the youngest claimants. An individual who lives for much longer than expected would be more likely to exhaust a lump sum award. Conversely, a claimant dying at a younger than expected age would be less likely to exhaust the award. The expected lifetime is an average: Few will die exactly on this average with most therefore dying either earlier or later. In some cases, death could occur much earlier or much later than the average, so any lump sum compensation may not actually achieve its objective in most cases.

For some elements of compensation, the most appropriate asset for a claimant to match the liability cash flows is a PPO. The PPO leaves the investment risk (as well as other types of risk) with the insurer and the IFoA is strongly supportive of the use of PPOs wherever possible.

Discount rate

Question 4: do you consider that the legal parameters governing the setting of the discount rate should be changed?

Yes No

Please give reasons.

The consultation paper indicates (paragraph 32) that to date there has been no definitive study of investment decisions. It is also not clear how lump sum awards could be assessed for adequacy when the losses suffered, for example lost future earnings, are expectations based on what might have occurred but for the accident. In our view the parameters for the discount rate are a legal or political matter outside the scope of the IFoA. Yet, there are some important financial comments that we believe should be emphasised, if the legal parameters were to be changed.

We note that there may be a requirement to use different discount rates for future losses that are linked to different inflation rates, but there may also be circumstances where the return and discount rate required should not be linked to inflation.

The setting of the discount rate with reference to yields on ILGs assumes a discount rate net of RPI is appropriate. While this rate may be suitable for some heads of damage, it is not consistent with the inflationary pressures applying to the cost of care elements of an award.

We note that in recent years cost of care inflation (ASHE) has been low or negative, inflation (as measured by RPI) has been higher than targeted, and real rates of return as represented by the yields on ILGs have fallen from the levels available in 2001 when the present discount rate of 2.5% was set. Consequently there is no direct link between the discount rate and the risk-free matching assets used to assess compensation awards. There are consequences of returns being lower than assumed which could include claimants investing in a more risky portfolio of assets in order to attempt to achieve the assumed rate of return. It should be noted that the greater the level of risk assumed the greater the potential return, but also that in the long term the realisation of the risks that have been assumed may lead to losses and thus the total return over a long period tends to the risk-free rate. In common parlance: there is no free lunch but there can be winners and losers.

It may be too simplistic to state that low investment returns have forced the hypothetical claimant to depart from investing solely in a low risk manner. It is possible that the hypothetical claimant would willingly accept a certain degree of risk in order to attempt to obtain a higher expected return which still meets their risk v reward appetite.

It should be noted that solely investing in ILGs does not remove investment risk. We note that whilst the nature of ILGs makes them as close to risk free as is possible, the use of ILGs does introduce risk for the investor. The payment pattern of ILGs, a series of (usually) increasing payments with a large final lump sum, is not a close match to the on-going regular costs of a claimant paying for care. Furthermore it is likely that

for some young claimants the duration of available ILGs would not match average future life expectancy. Claimants investing in ILGs would be at considerable risk from fluctuations in future reinvestment rates. However, the use of an average yield on ILGs for determining the discount rate need not presume investment in any actual portfolio of ILGs, since it is used simply as a measure of risk-free real returns under the matching framework.

Question 5: if you consider that the legal parameters governing the setting of the discount rate should be changed, what do you think they should be? Please give reasons and define any terms used.

As the award of a lump sum is at a point in time, the discount rate should be reflective of the returns available at that time for the expected period over which compensation is required. It is worth noting that this accuracy would produce a tension with stability.

The current approach to setting the discount rate is not necessarily appropriate for determining an award that is not linked to RPI. For certain heads of damage, it would be more appropriate to define the discount rate as net of average earnings indexation, which may, in turn, be considered to be a proxy for ASHE.

Although we comment on PPOs in more detail in later responses, the introduction of PPOs since the Wells v Wells decision enables courts to impose PPOs in suitable claims and for suitable heads of damage.

Question 6: if you consider that the legal parameters governing the setting of the discount rate should be changed, what investments do you think the hypothetical claimant should be deemed to make for the purposes of calculating the rate of return? Please indicate the types and proportions of assets that should be included in the hypothetical claimant's portfolio of investments. Please give reasons.

If it is decided that the legal parameters should be changed then the IFoA considers that this is one area where simplicity may not necessarily be an appropriate principle. It is quite likely that the initial proportion in each asset class would depend on the heads of damage and estimated longevity of the claimant. Similarly, the proportion invested in each asset class is likely to change over time based on the expectation of longevity and any requirement to maintain liquidity.

A significant problem with starting from a mixed portfolio is how to determine the appropriate yield, since this will inevitably involve assumptions, including for future inflation, which will be to a greater or lesser degree speculative. In principle the yields determined from a mixed portfolio ought also to be risk-adjusted, which in practice may bring the yields back close to the yields on ILGs.

Question 7: do you consider that the availability of periodical payments should affect the level at which the discount rate is set?

Yes No

Please give reasons and indicate what effect you think it should have.

As we noted in our comments to question 3, a PPO will often provide the best match for at least part of a claimant's liabilities. The calculation of a lump sum award in lieu of a PPO will provide a cash amount that will almost certainly not precisely meet the requirements of the claimant. Variation in actual investment return, cost inflation, longevity, or any other assumption used in determining the lump sum award will mean a gain/loss for the individual claimant. The use of PPOs should mean that the potential for these gains /losses is materially reduced.

Outcomes within the justice system should be consistent. Where lump sum awards are the only outcome claimants should have no financial gain or loss than if they had access to PPOs. In our view the PPO regime and the lump sum regime should be as closely aligned as possible, to avoid unnecessary arbitrage and to ensure a level playing field.

Question 8: should the court have power to depart from the prescribed rate?

Yes No

If so, should the terms on which it may do so be expressly defined?

Yes No

Please specify the terms and give reasons.

As already noted, we believe that too simple a methodology for calculating the discount rate may hide some of the complexity required to settle claims fairly. However the prescribed rate or rates should apply in the majority of cases. This approach would maintain transparency and stability.

We note that any powers to depart from the prescribed rate could encourage claimants to consider themselves as “special cases”, increasing the number of claims going to court and incurring additional costs to defendants which would almost certainly be passed on to taxpayers, or policyholders. Notwithstanding this, we consider that the Court should continue to have the power to depart from the prescribed rate in special circumstances, which are likely to be rare. The only ones that come to mind are where the claimant lives overseas and one or more of non-UK tax, inflation, and investment rates need special consideration.

Question 9: should the power to prescribe different rates be available for:

- | | | |
|--|---|--|
| a. different classes of case? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| b. different periods of time over which damages are paid? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| c. different heads of damages? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| d. cases where periodical payment orders are available and where they are not? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

If so, for which classes, periods or heads would you specify different rates? Please give reasons.

As previously commented, the IFoA believes that using different discount rates for different heads of damage would be appropriate, as they could reflect the different inflation measures. To prevent system abuse and the incurring of unnecessary costs, the methodology for different heads of damage would have to be clear. There is also good reason for using different discount rates for different time horizons. The current practice looks at the yield from ILGs, but there are insufficient ILGs for very long durations so determining a discount rate for those durations would require an element of approximation within the calculation. Given the importance of the discount rate for calculating the lump sum award for young claimants, a robust methodology for setting long duration discount rates is important.

The IFoA notes the recent decision in Hong Kong (the Chan Pak Ting case) and the use of different discount rates in Ontario. We believe that an approach using different discount rates at different durations could be acceptable within the UK.

We would not support the suggestion that different discount rates be prescribed depending on the availability of PPOs. In financial terms, the discount rate should be appropriate for the calculation of the lump sum award. Other circumstances should not have an effect on that discount rate.

We also believe that the same discount rate should be used for different classes of case.

Question 10: if you consider that the legal base for setting the rate should be changed, what methodology should be used to set the rate, including:

- what quantitative and qualitative data should be used (e.g. historic or forward looking, specific indices)?
- what assumptions should be made (e.g. asset mix, weighting of assets)?
- how should inflation be taken into account?
- what allowances should be made for tax, administration or management expenses and investment expenses?

Please give reasons.

The IFoA believes that it is more appropriate to set discount rates by considering forward looking returns. Historic returns are not necessarily an indication of future returns.

In terms of specific assumptions and indices, the overriding principle should be that the asset/index chosen should be appropriate to the characteristic of the liabilities being considered. An inflation linked liability should be assessed by an inflation linked asset or index. Where there is a choice of inflationary measure, the one selected should be similar to the inflation particular to that liability. We recognise the difficulty in always achieving an exact match, but a proxy should always be available. Any review of the discount rate should consider whether a proxy measure remained appropriate for the liability.

Tax and expense allowances should reflect the reality of any notional portfolio for the hypothetical claimant. The IFoA also believes that any changes to the net discount rate should include a suitable allowance for the implications of tax and investment expenses and should be risk-adjusted. In practice, basing yields on a risk free asset like index linked gilts means that “investment management” may be assumed to be unnecessary,

so no investment expenses need be deducted in that case. However, different investment portfolios would demand varying charges, and the discount rate selected must account for those differences.

Periodical payments

Question 11: do you consider that the present level of usage of periodical payments is appropriate and that no change is necessary?

Yes No

Please give reasons.

The IFoA PPO Working Party in its 2012 research has discovered that the take up rate for PPOs is around 10% for claims of £1m plus, but increasing to 80% for claim sizes of £5m and above. The Working Party has not carried out formal research into the reasons this may be so, whether it be simply a factor of quantum or whether, for example, the Court of Protection is more inclined to wish to see PPOs established for minors. A PPO will often provide the individual claimant with the most appropriate matching asset for their liabilities. If society wishes to leave claimants secure, PPOs should be encouraged. Many risks for the claimant are transferred to the government body or the insurer, with the exception of default risk. There are also currently some tax advantages for agreeing to PPOs rather than accepting lump sum payments. However, where claimants have the option to select a PPO, the level of usage of PPOs may be heavily influenced by the personal choice of claimants and/or their families. The reasons behind those decisions may be peculiar to the claimants and may not be obvious. However, the discount rate may only play a small part in the decision making process.

We note that the use of PPOs in England, Wales, and Northern Ireland increases with the quantum of the claim; therefore, there is a degree of selection dependent on the severity of the need. Indeed it may be difficult to envisage that PPO take up would increase for lower value cases and that high value cost of care cases would remain the most common scenario for PPOs.

There will be certain circumstances where PPOs cannot be used or implementation of them is more difficult, which we discuss further in our response to question 14.

The consultation paper does highlight the benefit that defendants obtain from making lump sum awards. Defendants may increase their lump sum offers to entice claimants away from pursuing PPOs. This would remove any direct link from the PPO and the amount of the lump sum award. Such offers may not be fully understood by the claimant in terms of the risks accepted from the potentially higher lump sum.

Question 12: if you consider that the present level of usage of periodical payments is not appropriate and that change is necessary, please indicate the measures that you think should be taken to increase their use.

Please give reasons.

The most comprehensive measure would be to mandate the use of PPOs as the default option, unless the judge considers that there was good reason not to use the PPO. As we note in our answer to question 14 there may be valid reasons for not taking up PPOs.

An alternative approach, which retains freedom of choice, would be to ensure that certain information about the option to use a PPO is always provided to claimants in a prescribed manner. Our response to question 13 provides more detail.

PPOs have increased in number significantly since the Thompstone indexation cases which resulted in the option to link the annual payments to ASHE. Given their increased use in recent years, as time elapses, damages experts may consider further the benefits arising from them.

Their use would be increased if there were the capability to order PPOs in Scotland.

We also consider that there is a potential issue with the risk of default attached to PPOs. For example, indemnity limits exist on employers' and public liability classes of insurance. Even at £10m, a value that remains fixed notwithstanding the effect of inflation on a PPO, it is possible that the indemnity limit will be breached for some claims, particularly those with long potential payment periods, with the liability then falling back on the insured party. It could perhaps be considered that there should be unlimited liability for these classes of insurance as there is for motor policies.

Question 13: do you consider that claimants and defendants are sufficiently informed about the availability of periodical payments and how they operate?

Yes No

Please give reasons.

The IFoA cannot specifically comment on information provided to claimants. The quality of that information is crucial to claimants being fully aware of the benefits and risks arising from lump sum awards and PPOs. However, members of the IFoA working in, or advising, insurance companies are fully aware of the availability of PPOs.

We have made a number of references to the inherent risks of lump sum awards for claimants. As we have suggested, it is crucial that claimants are fully aware of the type of risks they have and how PPOs, or lump sums, would mitigate, or magnify those risks. In order that claimants have the best information to allow an informed choice, there could be a requirement for all claimants to receive prescribed information about PPOs and lump sum awards, which sets out the benefits and risks of both.

Question 14: why are periodical payment orders not used in a larger proportion of cases? Are there, for example, types of cases where periodical payment orders are not appropriate? Or are there particular costs, obstacles, risks or circumstances which limit the use of periodical payment orders?

The IFoA does not have any information that would enable a full answer about the reasons for the current level of take up of PPOs.

However, as previously mentioned there may be good reason for not using a PPO. Examples of scenarios that may arise in England and Wales include claims where the defendant is to be considered 'insecure' (e.g. overseas insurer), in some claims where there is joint liability, where there is a limit on the defendant's indemnity, where there is contributory negligence, where there is no suitable index (the claimant might be living abroad), where there is no offer or a limited offer by defendant, where there is a large accommodation funding requirement (large Roberts v Johnstone shortfall), where the claimant has plans requiring capital, where the claimant's life expectancy is impaired and his claim includes lost future earnings (because his loss relates to his former life expectancy not his post-accident actual expectancy) and where there is a large contingency fund requirement due to above average uncertainties.

Scottish cases are covered in question 16.

Question 15: where periodical payments are used in conjunction with a lump sum, what determines the balance between the lump sum and the periodical payment elements of the overall award of damages?

To date, PPO awards have been most frequently used to cover the cost of care and, in very few cases, loss of earnings. It is common for the remaining heads of damage to be settled by means of a lump sum.

There are two issues at stake. Firstly, we have addressed whether PPOs are awarded or not elsewhere, with variation based among other factors on the desire of the claimant and/or defendant. However, we have no particular evidence on this point.

Secondly, our experience is again limited in understanding why PPO awards are made for some heads of claims, but not for other costs. Claimants may desire to invest a lump sum in property and adapt it for future use at the expense of future security. Alternatively, they may be acting to ensure a guarantee of a de minimis level of on-going funding for their costs of care while maintaining flexibility of their options with regard to the rest of the funding.

There may be other factors of which we are unaware and the IFoA is not best placed to answer this question fully.

Question 16 [Scotland only]: do you consider that there would be merit in reviewing the existing approach to periodical payments in Scotland? If so, please give reasons.

Yes, in order that claimants in Scotland have the same opportunity to take up PPOs as in the remainder of the United Kingdom.

Impact Assessment

Question 17: do you agree with the impact assessment that accompanies this consultation paper?

Yes No

If not, please give reasons.

Question 18: do you have any information regarding:

- the effect of the current discount rate on the size of awards of damages and as to the likely effect of a change in the rate on the size of awards in the future;
- on whether awards made under the present law turn out to be inadequate;
- on the reasons why periodical payments are used;
- the effect of periodical payments on the overall long-term total cost of awards;
- or on any other issues relevant to the assessment of the impact of the proposals under consideration?

If so, please could you provide details.

The consultation paper refers to the work undertaken by the IFoA's PPO Working Party Paper from 2011. This Working Party has produced papers for the years 2010-2012 and anticipates providing further research in the future. At the current time the PPO working party is looking in detail at mortality for severely injured claimants.

If the Ministry of Justice wished to discuss the research further, the IFoA would be delighted to meet with officials.

Question 19: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would affect the behaviour of businesses or voluntary sector organisations?

Yes No

If so, please give reasons.

The PPO Working Party market survey has indicated that different insurers have a different propensity to settle large claims as PPOs. It is possible that a change of approach to setting the discount rate could lead to changes in policy regarding PPOs for individual insurers. Behavioural changes could depend on the business mix of the insurer and the types of claim.

We are not in a position to comment about changes in behaviour for voluntary sector organisations.

Small Firms

Question 20: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would have any direct affect on small or micro-businesses?

Yes No

Please give reasons.

Any reduction in the discount rate would impact small or micro-businesses to the extent that the expected costs of their claims would rise. As a result there would be upwards pressure on insurance premiums. Furthermore with regard to Public and Employers' Liability, where indemnity is limited (typically to £5m or £10m), these limits may be breached, particularly in cases where PPOs are awarded. In these cases, the liabilities would fall back to the small or micro-business.

Question 21: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments must apply to small and micro-businesses as it applies to others?

Yes No

If not, please give reasons.

Whilst the effect on small or micro-businesses would be the same as for larger businesses the relative extent of the impact would potentially be greater. Where there is a risk that limits of insurance indemnity might be breached where PPOs are awarded, courts will consider the desirability of awarding PPOs. However where the party at fault is a small or micro business, and were payment of outstanding liabilities to fall back to the small or micro business, this could make the business insolvent and they may not be able to fund the payments to the claimant, who may not therefore be provided for.

Equalities impacts

Question 22: do you agree with the initial assessment of the equalities impacts of the possible changes under discussion in this consultation paper?

Yes No

If not, please give reasons.

There will clearly be effects on one class of individuals with a protected characteristic, that of the disabled. We do not consider that there would be any effect on other classes of those with protected characteristics. There should be a difference in approach for claimants depending on which class of insurance the claim falls. Motor policies provide unlimited coverage, whereas non-motor have limited liability. If there is considered to be any possibility that the limit of liability might ultimately be breached then the reasonable advice for claimants on non-motor policies would be to accept the lump sum. In the context of motor insurance affordability, any change to the discount rate would mostly affect younger drivers. This is due to the fact that this insured class represents a greater risk of incurring large value claims.

Question 23: if you consider that the changes under consideration in this consultation paper in relation to the discount rate or the use of periodical payments will affect people with different protected equality characteristics please give reasons and provide evidence of any ways in which this will occur.

About you

Full name	Philip Scott
Job title	President
Capacity in which you are responding to this consultation exercise (select all which apply)	Legal representative: <input type="checkbox"/> claimant/plaintiff/pursuer <input type="checkbox"/> defendant/defender <input type="checkbox"/> Insurer <input type="checkbox"/> Judiciary <input type="checkbox"/> Financial institution <input type="checkbox"/> Academic <input type="checkbox"/> Public sector body <input type="checkbox"/> Business <input type="checkbox"/> Equality group <input type="checkbox"/> Member of public <input checked="" type="checkbox"/> Other Professional Body
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<input checked="" type="checkbox"/> If you would like us to acknowledge receipt of your response please tick this box (emailed responses will be acknowledged automatically).	
Address to which this acknowledgement should be sent, if different from above	

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