Ministry of Justice - Draft Discount Rate Legislation
Personal Injury Discount Rate - Further Response By Nestor Financial Group Limited
October 2017

The Personal Injury Discount Rate: How it Should be Set in the Future - Response to the Draft Legislation

Our Credentials

The Nestor Financial Group is a director led firm of Independent Financial Advisers offering pre and post-settlement financial advice to personal injury claimants and their representatives. Nestor is based in the North-West of England and has clients across the whole of the UK.

We currently provide advice to over 700+ active clients, and total funds under influence (FUI) are in excess of £500 million (as at 31st August 2017). Since the introduction of the periodical payment regime under the Courts Act 2005, we are instructed annually to provide around 150+ Expert Witness Reports on the viability of periodical payments. We also implement around 400+ Personal Injury Trusts per year, thus helping personal injury claimants to maintain their entitlement to means-tested state support.

The directors at Nestor also have a good understanding of the intricacies of Local Authority Provision, State Benefits and the Court of Protection and Office of the Public Guardian, and act for over 120 Deputies under the Mental Capacity Act 2007. Our deposit cash management service looks after around £100 million in a range of deposit instruments. Our average sized investment portfolio is around £700,000 - the bulk of which is made-up of personal injury damages awards.

Our expertise within personal injury investment and Trustee financial planning, led us towards innovation and specialist product manufacture for this highly specialised area of financial advice. Our core investment strategy proposition is built around a cautious investment approach, and we undertake a significant amount of work for our clients centred on the reduction of volatility within investment portfolios. This culminated in our assisting Seven Investment Management (7IM) to create the UK's first bespoke investment fund aimed at personal injury claimants - 'The 7IM Personal Injury Fund', which offers a unique investment approach for this special class of investor.

The 7IM Personal Injury Fund was launched back in October 2009 as being a low-risk investment product, suitable for personal injury claimants who have recovered personal injury damages awards. Since launch, the fund has grown in size to over £280 million and goes from strength-to-strength. The fund, an Open Ended Investment Company (OEIC) is run and managed by 7IM.

Nestor Financial Group provided a response to the March 2017 discount rate consultation. A copy of our response is attached.

Discussion

On one of the key questions which also forms the basis of this additional paper: **'Do you consider that the law on setting the discount rate is defective? If so, please give reasons'** Nestor responded as follows:-

> '*No, Nestor does not consider that the law on setting the discount rate is defective. The well-known case of Wells v Wells [1999] 1 AC 345 concluded that Personal Injury Claimants should not be treated as 'ordinary investors' and should invest in Index Linked Gilts, or ILGs, due to the greater security compared to equities'.*

The Government, through the Lord Chancellor, is now proposing to legislate and effect amendments to the Damages Act. Under the draft proposed legislation, it is intended that personal injury claimants are to be treated as follows:-

Determining the rate of return 4 (S3):-

(d) the assumption that the relevant damages are invested using an approach that involves:-

(i) more risk than a very low level of risk, but
(ii) less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims.

The Lord Chancellor, when publishing outcome of the Discount Rate Consultation and Draft Legisliation stated:-

'I am therefore taking this opportunity to invite comments on the draft discount rate legislation that we have prepared to implement our proposals. I welcome responses from everyone interested in this topic'.

The Right Hon David Lidington MP

It is Nestor's view, which is grounded upon many years of experience of looking after the financial planning and investment affairs of personal injury claimants, that the proposed draft legislation and subsequent change of emphasis, which compels personal injury claimants to take investment risk (however low this appears to be) is an unfair and an unmerited departure from the 100% compensation principle, as set out in *Wells v Wells*.

It is also our view in concluding that, if the draft legislation is enacted, the current discount rate may rise to *'a range of between 0.0%-1.0%'* is based upon methodology and assumptions, which appear to have been derived by using, as yet, undisclosed evidence of how personal injury investors actually invest their damages post-settlement. It may be the case that organisations possess factual data as to how personal injury claimants actually invest their damages, but this information is not in the public domain and, as far as we are aware, there remains no published body of available evidence. Regardless of the reality of how a claimant invests, as will become apparent within this response, if the majority do take investment risk that is simply a consequence of the incorrect setting the correct discount rate during the previous 16 years.

Further, when the summary responses to the recent consulation are considered, the following emerges:-

4. ***Please provide evidence of how claimants actually invest their compensation and their reasons for doing so.***

39 responses to this question took the view that, in practice, claimants were investing in a low to medium-risk mixed portfolio of assets, with many of these responses from the insurance sector endorsing the evidence provided to the ABI. This evidence suggested that claimants were investing in a mixed portfolio comprising a range of assets. A few others pointed out again that no investor would invest in ILGS alone. A small number (11) offered some evidence of a lower risk to no risk investment strategy, and a few more again pointed out that claimants had in recent years been forced into higher risk investments than they would have liked at the 2.5% rate. Another seven respondents set out their view that how claimants actually invested was not relevant to how the discount rate should be set.

A significant proportion of respondents either did not have evidence, did not have access to the relevant information, or did not respond to this question. A few others said that it would depend on the facts of individual cases. Only a very small number suggested that claimants made alternative investments, like property, or alternatively kept the sum in cash.

We surmise that it is possible that undue weight may have been therefore placed upon the evidence supplied to the Lord Chancellor by the ABI, in how claimants actually invest their damages post-settlement, given the lack of publicly available information.

In our opinion, the correct starting basis for the calculation of future loss personal injury compensation is that the claimant invests into ILGS in accordance with the *Wells v Wells* principles, irrespective of where claimants actually invest their damages post-receipt. The fact that claimants do not invest in ILGS post-settlement, is irrelevant when setting the rate as the basis of a starting quantum calculation.

Submissions put forward during the recent consultation that *'claimants do not invest their damages in ILGS'* is, in our view, misleading. It is a simple fact that since *Wells v Wells* and the subsequent 2001 discount rate decision, which lowered the *Wells v Wells* rate to 2.5%, returns available on ILGS have consistently been unable to support this financial calculation objective. As a consequence of this, claimants have been forced to invest into risk-based assets, but this has not necessarily been through their choice or desire. The inertia of various Lord Chancellors over the last 16 years has now forced this issue.

Had the discount rate been adequately reviewed in light of falling returns available on ILGS since 2001, the discount rate would have reduced proportionately over time, reflecting fairer compensation during that period. In 2017, as a result of this inertia, practitioners were then faced with the dramatic reduction in the discount rate from 2.5% to -0.75%. This followed periods of intense pressure, by interested parties which has now prompted the proposed legislative amendments and fundamental calculation methodology change.

It now appears that the disparity between ILGS returns, the incorrect 2.5% rate for 16 years and the need for a claimant to invest their damages because of this, has created a body of evidence, which is now being used to support the movement away from the *Wells v Wells* calculation principles. In our experience, if personal injury claimants could achieve the required investment return to meet their lifelong needs without taking investment risk, in most cases they would.

In making these additional comments, Nestor have read and considered the 7th September 2017 discount rate documentation as follows:-

- The Personal Injury Discount Rate How it should be set in future: Draft Legislation.
- The Personal Injury Discount Rate How it should be set in future - Consultation Response.
- Government Actuary's Department - Ministry of Justice Personal Injury Discount Rate Analysis 19th July 2017.
- Correspondence between MOJ & GAD & HM Treasury on various dates between 19th December 2016 to 12th January 2017.

In addition to this information, we have also considered the following:-

- The Discount Rate - Report for MOJ authored by Paul Cox, Richard Cropper, Ian Gunn and John Pollock dated 7th October 2015.

Analysis of the Draft Legislation

We do not propose to comment upon the specific wording of the draft legislation, as we are not legally qualified to offer any specific views on the merits or otherwise of the wording of the proposals. Rather, we put forward views on the principles behind the intentions of the draft legislation within this response. Coupling our views on the theory with our extensive practical experience of advising claimants and their families both pre and post-settlement does put us in a unique position to assist with any draft legislation proposals.

We do, however, comment upon the various documents referred to above. First, our analyisis of the relevant sections of '*The Personal Injury Discount Rate How it should be set in future: Draft Legislation'*

Para 6:-

> *'On how the rate should be set, the consultation responses were divided as to the investment risk appetite that should be assumed in the setting of the rate (claimant interests generally favouring the present very low risk level and defendants a higher, but still low, risk level). There was, however, widespread agreement that claimants should be treated as more risk averse than ordinary prudent investors.*

Subject to this difference of opinion there was wide support for the general principles proposed for the setting of the rate. It was also clear, taking the responses and the results of other research together, that claimants invest in low risk diversified portfolios not in "very low risk" investments, such as Index Linked Gilts ("ILGs") alone.'

It is not surprising that there would be a difference between the two conflicting parties involved in the litigation process. That is generally the nature of civil litigation. Of interest, is reference to other research which has not, as yet, been made available.

Para 12:-

Under the new law, the discount rate will reflect the rate of return to be expected on a low risk diversified portfolio. There will probably be a range of portfolios and rates of return that might be used in the setting of the rate. It will be for the Lord Chancellor to apply the legal principles set out in the legislation and on that basis to decide where in the range of low risk the rate should be set.

It is our view that terminology such as 'low-risk diversified portfolio' is not helpful for claimants and their legal advisers. This type of terminology can mean many different things to different people, and is highly subjective. Low-risk diversified portfolio could be taken to mean any one from a plethora of solutions available. Variances of how to produce long-term investment returns for investors is evident today more than ever before. Conflicting views abound in respect of passive, active investing or advised or discretionary portfolios and many more. Much more clarity should be given to this special class of investor in our view, whilst still protecting some freedom of choice.

Personal injury claimants ought to have certainty, and be afforded certain clear protections from legislators. Their lifelong future loss damages, should not be the subject of ambiguous phraseology and ought to be clear in its intention.

Para 13:-

The key legal principle will be that the rate should be the rate that, in the reasonable opinion of the Lord Chancellor, a properly advised recipient of a lump sum of damages for future financial loss could be expected to achieve if he or she invested the lump sum in a diversified low risk portfolio with the aim of securing that:-

(a) The lump sum and the income from it would meet the losses and costs for which they are awarded when are expected to fall; and

(b) The relevant damages would be exhausted at the end of the period for which they are awarded. In this exercise the Lord Chancellor must consider the investments available and actual investments made by claimants; and must make such allowances for taxation, inflation and investment management costs as the Lord Chancellor thinks appropriate.

Again, terminology, 'low-risk diversified portfolio' is prominent. Further, the Lord Chancellor is making a broad assumption that a claimant benefits from 'proper advice'. In our experience, this pre-settlement advice is hit-and-miss at best. It is our view that 'proper advice' ought to be predicated with 'proper Financial Conduct Authority (FCA) Approved Person authorised investment advice'.

If, as is suggested, the claimant is expected to take investment risk with their damages in order to achieve the 100% principle, then, by definition, conversations about investment risk, return, volatility and tax efficiency must be undertaken by an FCA 'approved person'. It is our view that it is unlawful to proffer risk-based investment advice without the pre-requisite FCA approved person authorisation. At the very least, FCA core principles should be adhered to. A further key principle in our view, is managing conflicts of interest, particularly where claimant litigators refer personal injury claimants to their 'in-house' or owned/part owned financial advice or investment firms.

It cannot be in the claimant's best interests to settle their future loss lump sum damages claim without such authorised financial advice. In our experience, personal injury claimants do not have the benefit of investment advice, pre-settlement. In certain circumstances, claimants sometimes benefit from authorised advice in relation to the allocation of an award of damages on either a lump sum or a PPO basis, but it is our view that this is not the same thing, and is sporadic, at best. In any event, this pre-settlement allocation advice is not universal and many claimants settle their future loss damages awards without such advice. If, as suggested, the draft legislation makes an assumption that the claimant has to invest their award in a 'low-risk diversified portfolio' then this, in our view requires FCA approved person regulated advice pre-settlement on every occasion.

Para 27:-

Nonetheless, broadly speaking, based on the evidence currently available and without fettering the exercise of the Lord Chancellor's discretion in the future, the Government would expect that if a single rate were set today under the new approach the real rate might fall within the range of 0% to 1%.

Para 28:-

This estimate of what the range of rates might be under the proposed law is primarily based on the expected returns over longer award periods, contained in the report from the Government Actuary's Department published alongside this paper, and has been reached by making illustrative assumptions as to appropriate allowances for investment expenses and taxation. If return expectations reduce or the assumptions for investment expenses and taxation turn out to be under-estimates, the rate may be lower; or, if return expectations increase or the assumptions turn out to be overestimates, higher. The estimated rate also reflects the new assumption that claimants are to be assumed to be prepared to take a low level of investment risk. This assumption aligns with the evidence collected during the consultation on how claimants invest their awards in practice. Low risk is not a precise term and covers a range of possibilities, which would be expected to produce different investment outcomes at different discount rates. This is discussed in the Government Actuary's Department's report.

It appears that this potential discount rate increase to between 0.00%-1.00% has been arrived at with reference to the Government Actuaries' Department (GAD) report, which was commissioned by the Lord Chancellor and dated 19th July 2017. It is unclear, beyond this GAD report and the consultation outcome, what other evidence was relied upon and considered when arriving at this range of possible outcomes, as this evidence has not been made available. It is our view that the assumptions used in in the GAD report are subjective and problematic. This is dealt with later within this response.

It is our view that the GAD report, whilst thorough in principle, raises a number of issues. It is accepted that, whenever these types of historical analyses based investigations are undertaken, certain assumptions must be relied upon. These assumptions may, as you would expect, prove to be right or wrong over time. Source datasets may prove to be unreliable and not reflective of the reality of how damages awards are expended over time. The GAD report relies on a number of standardised assumptions, which may prove to be incorrect. Of particular concern, is the starting point of the asset allocation strategy as used to create their simulations.

For example, *Section 4.7* of the GAD report states:-

4.7 Our understanding is that the advisers gave a range of strategies to reflect potential different risk preferences amongst claimants. MoJ grouped these recommendations by risk tolerance and have provided us with an 'average' or 'representative' investment strategy for two portfolios:-

Portfolio A *- this is an average or typical portfolio invested in by personal injury claimants, based on evidence from wealth managers and investment advisers of what claimants do and are advised to do, which corresponds most closely with a "low risk" investment strategy for personal injury claimants; and*

Portfolio B *- this is an average or typical portfolio invested in by personal injury claimants, based on evidence from wealth managers and investment advisers of what claimants do and are advised to do, which corresponds to claimants who were described as taking more risk than claimants adopting Portfolio A. It is based on MoJ's interpretation as being representative of the highest risk investment strategy that wealth managers and investment advisers would recommend or have recommended to personal injury claimants.*

4.10 We have not independently verified the strategies above from the consultation responses. However during discussions with MoJ we have commented on the assumptions made by them in deriving these strategies and we are satisfied with the approach and assumptions in deriving these strategies.

4.11 However, we would stress that the strategies shown and analysed in this report are just two possible strategies and that there is no universally accepted definition of, say, a 'low risk investor' or a 'low risk investment strategy'. That said, we are satisfied that the strategies shown provide a reasonable range of the strategies advised to claimants and as this analysis is only intended to be illustrative, we think it is appropriate for demonstrating the potential range of outcomes.

The GAD report clearly states that the portfolio construction was *'based on evidence from wealth managers and investment advisers'* but there is no clarity as to the nature of that evidence, as it has not been made available. Clearly, proper detail of that evidence would be most welcome, and helpful to those advising personal injury claimants. When the respective GAD report asset allocation positions are considered, it is clear in our view that the suggested portfolios expose a personal injury claimant to unacceptably high levels of investment risk, in order to achieve the 100% principle.

As a starting point for assessing the discount rate, the suggested portfolios (as below), are a very long way from the current ILGS risk-free principle and force claimants to implement strategies with unnecessary levels of investment risk:-

Asset Class	Portfolio A	Portfolio B
UK Equites	13	29
Overseas Equities	15	28
Equities Total	**28**	**57**
Fixed Interest Gilts	15	7
ILGS	5	3
Corporate Bonds	21	14
Cash	10	5
Property	4	5
Alternatives (modelled as Hedge Funds)	18	8
TOTAL	**100**	**100**

The GAD report also notes:-

'Source: MoJ, GAD - may not sum to 100% due to rounding'

'A.6 Note that we have not independently verified the strategy above from the information received'.

'It is based on MoJ's interpretation as being representative of the highest risk investment strategy that wealth managers and investment advisers would recommend or have recommended to personal injury claimants'.

Further, there is little by way of explanation as to which category of asset classes the GAD report have used for their analysis. The GAD report *(Appendix A3)* goes on to state:-

A.3 In deriving these strategies, a number of assumptions and judgements were required.

For example:-

Some of the information provided by the advisers is unclear on the exact type of investment.

For example:-

It is not clear as to whether 'Fixed Income' refers to conventional fixed interest gilts or corporate bonds. Assumptions have been made that allocate positions between appropriate asset classes. Allocations to corporate bonds are assumed to be made to investment grade corporate bonds. In an attempt to keep the modelling simple, we did not generate returns for all possible asset classes. Instead we decided to make some assumptions on reasonable approximations

For example:-

Overseas Government Bonds are modelled as UK gilts. High Yield bonds are assumed to be modelled as a 50% allocation to overseas equity and a 50% allocation to investment grade credit.

All 'alternative' investments (such as 'commodities', 'alternatives' and 'other') are modelled as a 'Fund of Fund Hedge Funds' within the ESG.

Investment in infrastructure is modelled as property.

We have no significant disagreement with the GAD report projection that a portfolio such as Portfolio B with a high equity content would have a fairly high probability of delivering a long-term return in excess of the required rate, i.e. over-compensating the claimant over a 30-year term, *if* the GAD report scenario assumptions for costs, cashflow needs for the investor and projected investment returns are reasonable. However, we would like to proffer some observations about these assumptions and the risk that they may not be entirely reasonable.

Our further observations are in relation to the apparent limited attention paid by the GAD report to analyse the potential volatility of returns and the risks of sharp portfolio losses occurring and either causing an investor to liquidate the portfolio (due to behavioural factors and risk aversion) or coinciding inconveniently with capital spending needs thus causing a meaningful impairment of the portfolio's long-term return potential. It seems unusual for what is effectively a long-term (30-year) financial modelling plan to ignore the issue of investor risk aversion, i.e. tolerance for risk as well as financial capacity for risk.

Given the lack of disclosed supporting evidence to justify these types of asset allocation strategies, it is difficult to see how, after 16 years of damages calculations being linked to average returns on ILGS, it is now possible to expect that personal injury claimants would be forced to invest in sample portfolios, ranging between 28%-57% in equity based asset types just to meet their income and capital needs as a result of negligent action, as a calculation principle. This, in our view does not fulfil the 100% principle.

In our experience, we believe that most claimants would not be comfortable taking on the levels of unnecessary risk which inevitably fall from the suggested portfolio asset ranges. It is apparent, when considering the GAD report that the MOJ has proffered this asset allocation as being worthy of analysis, when considering how the discount rate could be set:-

'It is based on MoJ's interpretation as being representative of the highest risk investment strategy that wealth managers and investment advisers would recommend or have recommended to personal injury claimants.'

Section 4.7 of the GAD report

This interpretation was, of course, predicated on the simple fact that the 2.5% discount rate was left untouched for fully 16-years, during which time returns on ILGS reduced dramatically. The consequence of this was that personal injury claimants were compelled to invest some of their capital into risk based assets, just to sustain their future needs. It now appears that the, as yet, undisclosed evidence used to support the draft legislation is being used against future personal injury claimants, most unfairly, in our view.

The GAD report return projections, assuming that the asset allocations of both Portfolios A and B are sound methodology, appears in our view to be reasonable. However, it ought to be acknowledged that there is no universally accepted approach to long-term asset class return forecasting. Any such exercise is inevitably dealing with an uncertain future. This degree of uncertainty in forecasting is an important factor, and has the potential to be more intense in more volatile portfolios with higher equity content, which may be expected to have a wider range of plausible future returns.

While it is the case that, under the GAD report assumptions, it is accurate to project that the median claimant would be overcompensated on a gross basis over 30-years, with a small probability of undercompensation, it is also the case that under relatively modest differences in assumed returns (or, crucially, under modest differences in outcomes versus projections) the level of overcompensation (gross of cost) would be reduced and the weight of claimants being undercompensated could be more significant. Given a lack of universal consensus on such long-term asset return forecasting, it might be reasonable to consider a range of other asset return forecasts in order to fully reflect the impact on claimants and median/tail outcomes if asset return projections proved to be too optimistic or, indeed, too pessimistic. Indeed,the GAD report does acknowledge that: 'alternative views that cover both higher and lower simulations of returns and inflation do exist'.

Whilst we are not suggesting that alternative approaches are superior or inferior to the GAD report assumptions, but simply stress the point that there are valid differing approaches to projecting long-term asset returns, which may result in meaningfully different assumed portfolio returns.

By way of an example, 7IM work with Morningstar to help to build long-term projected asset return forecasts as part of their strategic asset allocation process. 7IM offer a range of risk-rated investment solutions, which includes the 7IM Personal Injury Fund. Morningstar are a globally recognised investment research house.

By applying these asset return assumptions to the GAD report proposed Portfolios A and B, we are able to arrive at similar, yet not identical, long-term projected return expectations for the asset mixes as described within the GAD report.

Applying the 7IM/Morningstar return projections to these proposed portfolios results in a projected *gross* return of 3.4% annualised nominal geometric return for Portfolio A (GAD report *section 5.14* - 4.0%) and 4.2% annualised nominal geometric return for Portfolio B (GAD report *section 5.14* - 4.7%). Adjusting for the GAD report assumption of 2.7% long-term inflation, these projections would be modestly lower than the GAD projections for the same portfolios (A: 3.4% v 4.0% or B: 4.2% v 4.7%), thus resulting in a lower probability of meaningful overcompensation and a higher probability of investors experiencing undercompensation outcomes, especially when taking account of investment costs and taxation.

The GAD report analysis also assumes a steady decumulation process throughout the life of the claimant, rising in line with cost inflation. This assumption makes no allowance for the possibility of accelerated or uneven spending needs or the possibility of capital needs in the short or medium stages of the life of the claimant post-settlement, which, in our view, is a more realistic scenario, and one which is universal for most claimants.

For example, a more equity based portfolio, such as Portfolio B, may be expected to deliver the claimant's long-term needs under the steady decumulation scenario as outlined within the GAD report.

However, the possibility of significant intermediate-term capital spending needs coinciding with periods of financial market volatility (resulting in a significant fall in value for the invested portfolio), and is not explicitly considered in the GAD report.

Section 5.6 of the GAD report recognises that '*making a significant withdrawal from the fund following an early fall in asset values will hinder an investment manager's ability to recover the fund in subsequent periods.'* The GAD report, however, then only focuses on a scenario of making 30 equal (inflation-adjusted) annual fixed withdrawals over the life of the claimant, without any further exploration of the impact of a claimant needing to make larger withdrawals at an earlier stage and the potential negative interaction of such capital needs with market volatility. This, in our view, is a vital, but missing, component of a full analysis. It should be clear that risk of long-term under-compensation is greatly increased in scenarios when market corrections coincide with significant short and medium-term capital spending requirements. Furthermore, it should also be clear that a more volatile portfolio is at greater risk of experiencing a significant correction per-se, and therefore of being impaired by necessary withdrawals coinciding with a period of weak portfolio valuations.

The GAD report analysis also appears to pay relatively little attention to the volatility of the proposed portfolios over shorter and intermediate time horizons, favouring to focus solely on a 30-year term of investment. It may, indeed, be the case that an award based on the assumption of an equity based portfolio, such as Portfolio B, could result in overcompensation over a 30-year horizon, but the behaviour of the investment portfolio over shorter timescales should, in our view, also be regarded as highly relevant. This, in our view, ought to have been given more weight and analysis in the GAD report.

We have already noted the possibility of a significant correction or drawdown coinciding with a need for the claimant to make significant capital withdrawals from the portfolio, impairing the ability of the portfolio to recover and meet longer-term objectives. For this type of personal injury investor in particular, an aversion to severe mark-to-market price volatility and medium-term portfolio losses might be a common feature, based both on limited appetite for risk and limited financial capacity for risk. For any portfolio required to deliver a long-term objective, behavioural factors may also come into play. In effect, it is necessary that the claimant feels sufficiently confident in the investment strategy to maintain it during periods of adverse market experience. This, in our view, is a crucial element of the outcome for a personal injury investor.

If an investment portfolio creates excessive volatility relative to the risk tolerance of the investor (which, we assume ought to be meaningfully lower than average for a personal injury investor), results in the investor giving-up on an investment strategy and liquidating at an inopportune moment, then the strategy has failed in its objective and may be regarded as unsuitable for the investor. This means that the short to medium-term volatility of the portfolio, while theoretically of limited importance on a 30-year view may be of significant importance in practical terms when considering likely investor behaviour. We are concerned that the suggested GAD report Portfolios A and especially Portfolio B, may be characterised by potentially significant volatility, risking such an outcome - and that their proposed structure may be particularly vulnerable when their behaviour in plausible stress test environments is considered.

We have considered the projected long-term returns for Portfolios A and B as above, but the volatility of returns around these long-term projections is also, in our view, a key consideration. Time horizon and methodological approaches will clearly have a significant effect on projections, as is the case in any forecasting exercise, and therefore we recognise that there would be a valid case for a variety of approaches to modelling volatility, which inevitably may provide differing results. We would suggest that this is an important part of the analysis which is, in our view, is underdeveloped in the GAD report.

For example,using a three-year look back period on a Barra[1] risk model, we would model a standard deviation of returns of 6.2% for Portfolio A and 8.3% for Portfolio B, although this obviously takes into account the relatively benign period for financial markets over the preceeding few years.

Using, however, a longer lookback period, again, on the Barra Long-Term model, with an eight-year half-life (effectively covering a full business cycle) the expected standard deviation of returns for the two portfolios would be 8.1% for Portfolio A and 10.7% for Portfolio B.

Turning to a Value at Risk analysis, again using a Barra risk model, we would estimate an annualised Value at Risk (i.e. an expected maximum annual loss with a confidence level of 95%) of 13.3% for Portfolio A and 17.6% for Portfolio B, using the eight-year half-life lookback period. This can be understood as an expectation that a portfolio invested according to the two GAD report strategic asset allocations (A and B) should expect to encounter a loss of at least this magnitude once every 20 years. We therefore find it puzzling that portfolios with such significant drawdown potential could be considered a suitable choice for a personal injury low-risk investor. On the basis of these volatility and Value at Risk characteristics, we would suggest that it is very difficult to define either portfolio as being 'very low-risk'.

This situation becomes more concerning when we consider the potential behaviour of both Portfolio A and Portfolio B as illustrated within the GAD report under market stress scenarios. We have analysed these two portfolios under certain historical scenarios, using the Barra risk model, in order to assess their potential behaviour if similarly severe scenarios were to recur, as would seem plausible on a forward looking, 30-year horizon, given that all historical stress test scenarios that have been explored took place within the last 30 years. The results appear to suggest that investors in Portfolio A (and particularly Portfolio B) would be exposed to very significant mark-to-market volatility under plausible stress scenarios.

While a well-managed and well-structured portfolio may, indeed, be able to recover from such a drawdown in a stress period, such levels of volatility unnecessarily expose the personal injury claimant to the risk of either being a forced seller of part of the portfolio at a very inopportune moment in order to fund capital needs, or being vulnerable to behavioural factors and 'selling at the bottom' if perceived portfolio behaviour is incompatible with the expectation of a very-low risk tolerance.

Unfortunately, the experiences of real investors in 2008-09 suggests that this concern is only too valid:-

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[1] *The Barra Integrated Model (BIM) is a multi-asset-class risk model that couples breadth of coverage (Global equities, global bonds, currencies, commodities, and hedge funds) with the depth of analysis provided by local models. Users need not choose between granularity of local model analysis, on the one hand, and the broad scope of global analysis, on the other. BIM can be used by institutional investors in their investment processes, from analyses of a single-market portfolio to a planwide international portfolio of equities, bonds, and alternatives.*

BIM is a valuable addition to an investment management process for two simple reasons. First, one needs to understand risk in order to manage it, and risk factors provide a parsimonious way to visualize and forecast portfolio risk. Second, risk forecasts find their ultimate usefulness when combined with return forecasts; by definition in an optimal portfolio, the risk of each segment is aligned with the expected return. BIM is thus central to the process of risk budgeting.

BIM has four main features that make it superior to other factor-type risk models.

It provides local detail, market by market, including both traded and private asset classes. Specifically, it provides ***fundamental factor*** *covariance forecasts over multiple horizons for assets in 90 equity markets, 60 bond markets, 161 currencies, 34 commodities, 31 private real estate markets, 9 hedge fund strategies, and global private equity and debt.*

It provides global aggregation of those markets for a multi-asset-class (MAC) portfolio.

It can forecast risk over multiple horizons, and thus provides the right amount of responsiveness to recent events.

It is robust: By modeling the structure underlying assets' behavior, it can differentiate between noise and information.

	1987 Market Crash (Aug-Nov)	1994 Rate Hike	Full Sub-Prime Crisis Oct 2007- Feb 2009	2008-2009 Global Financial Crisis
Portfolio A	-11.49%	-6.66%	-21.41%	-20.42%
Portfolio B	-18.05%	-7.34%	-28.63%	-25.20%

In our view, it seems unlikely that Portfolio B in particular could be reasonably described as a 'low-risk diversified portfolio' as such, and we would also have significant reservations about regarding Portfolio A as a truly 'very low-risk' construct. We are concerned that the implications of the GAD report leans too heavily on the long-term potential return outcome (which may still be undermined by uncertainty on forecast/projection accuracy, costs and varying investor cashflow needs) and place insufficient weight on the importance of managing short to medium-term volatility.

Further reading of the supporting documentation in relation to the draft legislation, and forming part of the consultation, it is our understanding that the MOJ corresponded with HM Treasury for their thoughts and observations. HM Treasury commented as follows(1):-

9. *It is the Treasury's view that the "mixed portfolio" of the type developed by the expert panel report in October 2015 represents a more appropriate benchmark for the PIDR than ILGs alone. The results of the extensive financial analysis conducted by the expert panel in Appendix 2 of their report supports this conclusion.*

   In particular:-

   a. *A 100% ILG investment lies very far from the efficient frontier of achieving the best return for a given degree of risk, as it offers much poorer returns and significantly higher volatility than a "best risk" portfolio of bonds and equities (Chart 9).*

   b. *In the period since 1983, the largest sustained drop in the market value of ILGs relative to RPI has been almost 30% (Chart 5) and there have been ten two-year periods where ILGs returns relative to RPI were negative (Chart 7).*

   c. *Chart 4 also notes that there are other portfolios with UK corporate bonds, which have risk equivalent to ILGs (where risk is measured by price volatility), yet offer higher returns. As a result, "ILGs have produced the lowest investment return per unit of downside risk [relative to RPI] over time".*

   d. *In the period 1999-2014, by investing 25% in the "best risk" portfolio (to provide liquidity) and 75% in ILGS (held to maturity), an investor would have earned returns above RPI while facing, at worst, a 2.2% fall in the value of their overall portfolio at any given moment (Chart 13). We note that this "mixed portfolio" is still 75% weighted with ILGs, and represents a cautious approach.*

10. *In light of the inevitable exposure to market risk that investors face, we believe the analysis in the Expert Panel's report clearly supports a mixed portfolio approach as the right solution for risk-averse investors. Indeed, the panel was unanimous in its view that the mixed approach was the optimal solution, if risk-averse investors could be regarded as pursuing a more realistic "very low risk" investment strategy rather than the hypothetical "zero risk" strategy of simply holding ILGs to maturity.*

11. *While the Panel could not agree unanimously on which of these perspectives was appropriate, it noted explicitly that "it would appear that the Lord Chancellor's decision is one of whether a "very low-risk" portfolio or a "risk-free" portfolio is consistent with the current legal framework." In subsequent correspondence, certain members of the panel noted that continuing volatility in financial markets meant that "the advice we gave you in our report about both anticipated risk-free real returns and returns from low risk portfolios all [now] requires revision."*

In our view this further confirms the impossibility of adopting an entirely "risk-free" approach; since the profile of a claimant's costs can never be predicted with certainty, and the market price of any investment including ILGs can vary, all approaches must involve a degree of exposure to market risk.

(1) HM Treasury response to MoJ Consultation: The Damages Act 1996 - Discount Rate dated 12th January 2017

The HM Treasury correspondence above, refers to the Expert Panel report published in October 2015. This was a report commissioned by the MOJ and authored by Paul Cox, Richard Cropper, Ian Gunn and John Pollock. This report considered: the *current legal framework and a reworking of the past approach in current economic circumstances* excerpts of which are detailed below:-

1.1 The function of this report is to assist the Lord Chancellor, and his counterparts in the devolved administrations, in their review of the responses to the first of the two consultation papers issued by the Ministry of Justice in 2012 and 2013. The first was entitled Damages Act 1996: The Discount Rate and how should it be set. The second was entitled Damages Act 1996: The Discount Rate -Review of the Legal Framework.

4.1 This chapter adopts a financial economics approach to the discount rate. In adopting this methodology it is implicitly assumed that a departure from a risk-free/market consistent approach, as considered in Chapters 1 and 2, is still consistent with the principles adopted in Wells and by the Lord Chancellor in 2001.

4.2 This is a minority view of the panel. The majority of the panel are not persuaded that this is correct, but ultimately it is a matter for the Lord Chancellor to decide.

4.3 A financial economics approach can arrive at a range of discount rates, depending on appetite for non risk-free assets. The panel has alighted on two portfolios within a range that might be deemed appropriate.

4.4 The first is a combined portfolio that has one-half invested in ILGS and one-half in the optimal mix of risky investments. This has only half the investment risk than if the whole amount was invested in the optimal risky investment portfolio.

*4.5 Based on the analysis contained in Appendix 2, the emerging discount rate is **0.75%** and the risk (standard deviation) +/-2.5%.*

4.6 The majority among the panel do not believe that this portfolio is potentially appropriate for a very low risk, but not a 'risk free', investor and the 100% rule. The minority view is that this portfolio would be appropriate. If adopted, it would be a matter for the Lord Chancellor to decide whether to round the rate up or down, to the nearest one-half of one per cent.

4.7 *The second is a combined portfolio that has three-quarters invested in ILGS and one-quarter in an optimal mix of risky investments. This has only one-quarter the investment risk than if the whole amount was invested only in the optimal risky investment portfolio.*

*4.8 Based on the analysis contained in Appendix 2, the emerging discount rate is **0%** and the risk (standard deviation) +/-1.25%.*

4.9 The panel is in complete agreement that, if forced to accept some investment risk, then the second portfolio (three-quarters ILGS and one-quarter in an optimal mix of risky investments) is potentially appropriate for a very low risk, but not a 'risk free', investor and the 100% rule.

4.10 The panel is also in complete agreement that portfolios combined using less than one-half invested in ILGS and more than one-half invested in the optimal mix of risky investments are inappropriate for a very low risk investor - the risk is too high.

Further detail on the material discussed in this chapter is provided in Appendix 2.

4.11 Case law, and the basis of our instructions, indicates that the hypothetical claimant in a personal injury situation must be regarded as having very low risk tolerance. A very low risk tolerant investor may at least be expected to assume some investment risk, and if the pool of potential investments is extended beyond risk free investments then this makes a financial economics approach, rather than the risk-free market consistent approach considered in Chapter 1, a possible alternative way to establish the discount rate.

4.12 A financial economics approach uses the long-run rate of return on an investment portfolio to determine the discount rate. Actuaries use risk-free discount rates in very many insurance and pension applications, as discussed in Chapter 2, but in other applications, say when ongoing contributions are being made to a pension fund with an excess of assets over liabilities and a sponsoring employer with a strong covenant, discount rates could be set with reference to non-risk-free benchmarks.

4.13 The financial economics approach to setting the discount rate in a personal injury context is to use the long-run rate of return on a very low risk investment portfolio. Appropriate investment metrics and measures need to be applied to establish that the investment portfolio is very low risk. No single investment metric is sufficient to do this and a combination is needed. Once a very low risk mixed investment portfolio has been determined, the discount rate is the long run real expected return on the portfolio, after taxation and management expenses.

4.14 Downside risk measures are the most important for this study because the claimant is assumed to draw a regular income from the portfolio. If the portfolio falls relative to RPI, more units of the fund have to be encashed than intended to pay the same real income to the claimant. If the fall relative to RPI is persistent more units will again need to be encashed. The effect will be similar if the fall is short but substantial. In both cases, a higher long-run future investment return may then be required in order to be able to sustain the same regular income into the future, and that may not be achievable while maintaining very low investment risk.

The Discount Rate - Report for MOJ,Paul Cox, Richard Cropper, Ian Gunn and John Pollock, 7th October 2015 '*The current legal framework and a reworking of the past approach in current economic circumstances.'*

The extracted relevant sections of their report indicated that the panel unanimously agreed, that if there was to be a movement away from risk-free (ILGS) return to 'very low-risk' return that the desired strategy would comprise 75% ILGS and 25% in optimal mix of risky investments would produce a return of **0.00%**:-

'*The panel is in complete agreement that, if forced to accept some investment risk, then the second portfolio (three-quarters ILGS and one-quarter in an optimal mix of risky investments) is potentially appropriate for a very low risk, but not a 'risk free', investor and the 100% rule'.*

It appears that both HM Treasury and the MOJ commissioned Expert Report of 2015 concurred that the correct 'very low-risk' approach would be the most suitable, should the Lord Chancellor choose to depart from the *Wells v Wells* no-risk principle.

It is therefore appears that the GAD report does not analyse this asset allocation model when arriving at their findings, and indeed proffers Portfolio B which involves around 70% in risk based assets (57% equity, 5% property and 8% alternatives) as a suggestion and as the basis for analysing simulations.

It is our view that if, as suggested, the Lord Chancellor is minded to move away from the *no-risk* calculation to a *very-low risk* calculus model, then the GAD assumptions used when modelling portfolio A and B are exposing personal injury investors to significantly more risk than both HM Treasury and the Expert Panel would suggest. This level of additional investment risk is, in our view, unacceptable for a personal injury investor.

The MOJ commissioned October 2015 Expert Report goes on to state:-

4.15 The type of risk described above is called sequencing risk, and is critically important when drawing an income over time from an investment portfolio. Sequencing risk occurs where one year of below RPI investment returns is immediately followed by another, which is immediately followed by another etc. Poor investment return sequences combine with portfolio withdrawals in a highly destructive way because more fund units need to be enchased to generate the same annual income. The double erosion of capital following a market fall -the market drop and the drawing an equal income at depressed fund value -is what makes sequencing risk potentially destructive. One of the lessons of the technology boom and bust followed shortly by the financial crisis was the importance of the order, or sequence, of extreme investment returns. If a sequence of market drops means the capital of a fund is 50% lower than planned, a 100% gain is needed to return the fund to where it should be. By knowing about sequencing risk portfolios can be constructed to reduce it.

4.16 Standardised general measures of variability, of which standard deviation is by far the most used, are less important in an income drawdown environment, but standard deviation remains very useful when it comes to making statements about likelihood and attaching a level of confidence to a particular set of results reoccurring. If the investment portfolio constructed has approximately normally distributed investment returns, more informed statements about likelihood and chance can be made.

4.17 Chapters 1 and 2 considered the issue of setting the discount rate by reference to risk free returns, in excess of the RPI, as discussed in Chapter 3. A set of risk free investments is envisaged, matching the anticipated cash flows as they fall due in future. A portfolio of ILGS is envisaged. This chapter takes a financial economics, mark-to-market, fair value, total return approach. A mix of risky investments is assumed to be held, increasing return. There will as a consequence be variability around the short-term, mark-to-market value of the portfolio, but as long as this is deemed to be tolerably small such portfolios may, for some investors who can tolerate risk, fit with a very low risk investment approach.

4.18 To construct a potentially appropriate mixed investment portfolio, two long-run datasets are used that industry and academia hold in high regard. These are the Barclays Equity Gilt study and the Dimson, Marsh, Staunton, datasets. Both are based on annual investment performance data from 1900 to 2014 inclusive, to give 115 years of data. This time period includes deflation and inflation, the two World Wars, and since 1980 the dotcom boom, bust, financial crisis, US crash of 1987, 1997 Asian foreign exchange crisis, as well as different economic regimes - RPI from 9% to 1%, recession and boom.

4.19 The asset classes need be to be diversified and so should be held in the form of index investments. Fund managers establish low charge funds for investors that replicate these indices. There will be transaction costs involved in managing the investments, as well as management costs and charges. To allow for this the analysis deducts 100 basis points, or 1%, from the annual performance of each bond index as an estimate of the after cost performance and 1.25% annually from each equity index.

This includes an allowance for tax. All the figures quoted throughout this report are after deducting these amounts – i.e. all figures are net of costs, charges and taxes. We appreciate that this is a 'broad brush' approach to the question of the appropriate deductions for tax and management expenses, which is open to challenge, but time constraints have not permitted a fuller investigation of this issue.

4.20 The following five downside risk measures are used to determine whether an investment portfolio is very low risk:-

Sequencing risk
Drawdown
Downside deviation
Value at risk
Conditional value at risk

These five risk measures must point to a very low likelihood of distressed selling and strong protection of capital relative to RPI. To be consistent with the investment risk objective the portfolio assembled will need to have:-

- *Very little sequencing risk, i.e. not be prone to a succession of below inflation investment returns.*
- *Very limited peak to trough drops in market value (drawdown risk).*
- *A low level of downside risk (semi-variance, downside deviation, and Value at Risk).*
- *Low exposure to tail risks within the worst 5% of expected investment returns (Conditional Value at Risk).*
- *A narrow dispersion of real returns over time (tracking error to RPI, standard deviation).*

4.21 We consider these to be the key metrics to judge suitability when taking a financial economics approach. These metrics are more fully described in Appendix 2.

4.22 An optimal investment portfolio is identified using a technique developed by financial economists known as modern portfolio theory. This combines assets in an optimal way, assigning more weight to assets having low correlations with one another. The requirement to adopt modern portfolio theory is embedded within prudent investor rules and the concept of fiduciary duty both in the UK and overseas. The analysis at Appendix 2 concludes that the optimal mix of risky investments is 50% in corporate bonds, 30% in overseas developed country government inflation linked bonds, and 20% in equities.

4.23 The panel is in complete agreement that the risk measures associated with this optimal mix of risk investments is too high. The expected annual real investment return is 2.5%, significantly above risk free returns, with standard deviation (risk) of +/-5.0%.

4.24 A way of reducing risk is to only invest one part of the investor's capital into the optimal mix of risky investments and the other part in risk free investments (ILGS). Two portfolios have been analysed that could, for some investors, be considered to be very low risk. The two portfolios chosen are based on the same optimal mix of risky investments. The two portfolios differ only by the proportion held in the optimal mix of risky investments and the proportion held in risk free investments. We are conscious that if departing from a risk free investment approach that 'very low risk' is something that will mean different things to different investors. There is not a unique answer to the problem, once a departure is made from a risk free framework.

4.25 The two portfolios have been relatively stable through different market regimes. Neither portfolio has significant sequencing risk, and both have approximately normally distributed investment returns.

4.26 The first of the two portfolios has 50% of the investments in ILGS (presumed to have no risk), 25% in corporate bonds, 15% in overseas developed country government inflation linked bonds, and 10% in equities. The expected long-run annual real investment return on this first portfolio is:-

Asset	*Portfolio weight (%)*	*Portfolio return (%)*
Risk free/ILGS	*50*	*-1.0%*
Corporate bonds (25%), Overseas developed country government inflation linked bonds (15%), Equities (10%)	*50*	*2.50%*

4.27 This first portfolio has a standard deviation of real investment returns of 2.5%. The standard deviation tells us that over time:-

- *Two in every three years the real annual investment return is expected to be between -1.75% and 3.25% from RPI.*
- *19 in every 20 years the real annual investment return is expected to be between -4.25% and 5.75% from RPI.*

4.28 The second portfolio has 75% of the investments in ILGS (presumed to have no risk), 12.5% in corporate bonds, 7.5% in overseas developed country government inflation linked bonds, and 5% in equities. The expected long-run annual real investment return on this second portfolio is:-

Asset	*Portfolio weight (%)*	*Portfolio return (%)*
Risk free/ILGS	*75*	*-1.0%*
Corporate bonds (12.5%), Overseas developed country government inflation linked bonds (7.5%), Equities (5%)	*25*	*2.50%*

4.29 This second portfolio has a standard deviation of real investment returns of 1.25%.

The standard deviation tells us that over time:-

- *Two in every three years the real annual investment return is expected to be between -1.25% and 1.25% from RPI.*
- *19 in every 20 years the real annual investment return is expected to be between -2.5% and 2.5% from RPI.*

4.30 The panel has mixed views, as set out above, about the appropriateness of the two portfolios, and, on the matter of the reasonableness of departing from a risk-free framework.

4.31 It is a matter for the Lord Chancellor to consider whether such a departure is appropriate.

The excerpts above reflect the detail of analysis undertaken by the MOJ commissioned Expert Panel within their report of October 2015. Their longer-term analysis of various portfolio mixes, appears to lead to a conclusion that on any view, portfolios with 20% or upwards invested in equites may not be suitable as being considered to be 'very low-risk' given levels of potential drawdown and other factors. By contrast, the GAD report analysis draws differing conclusions. Sadly, only time will tell which approach will be followed, but it is our view that legislators are under a duty to protect future outcomes for personal injury claimants as best they can. This can only be achieved if the evidence that they rely upon, when making such decisions is suitably robust and consistent in the first place.

The GAD report also deals with the issue of investment costs and taxation. Within their analysis, and in order to provide support to the proposed legistlation, they assume certain cost and taxation assumptions, as excerpted below:-

7.1 As outlined earlier, the projected returns from the ESG are gross of investment fees, management charges, adviser fees and taxes. Since an investor will have to meet such deductions, the actual returns achieved by the investor will be less than indicated in section 5 and if allowance for these factors is not included in the PI discount rate for these factors then the claimant will tend to be under-compensated by comparison.

7.2 Alternative analysis that includes suitable allowance for expenses and tax will result in different levels of under- and over-compensation to those outlined in the previous section. However we believe that the analysis provides a reasonable representation of the spread of outcomes and that outcomes that include a suitable allowance for expenses and tax can be deduced from the range of results presented on different PI discount rates.

7.3 The appropriate allowance for expenses and tax is likely to depend on a number of factors and assumptions and will require a degree of judgement. As such further work is likely to be needed to determine the reasonable allowance for expenses and tax. That said, based on an initial high level assessment, we believe that a deduction of around 0.5% is likely to be reasonable.

The MOJ commissioned Expert Panel report is notably different from the GAD report on the issue of investment costs and taxation. For the purpose of the GAD report analysis, 0.5% is suggested to cover charges and taxation as above, whereas the MOJ Expert Panel suggested 1.00% for bonds and 1.25% for equites. Both reports conceeed that these are 'broad-brush' assumptions and that further work may be required to analyse the effects of investment charges and taxation further.

As a starting point, there is obviously a significant difference between the two reports. It is our view that using an arbitrary 0.5% to cover costs and taxation is simply insufficient. Personal injury claimants ought to be afforded the benefit of good, sensible and ongoing financial and investment advice, which inevitably costs money. The difference between the two figures can amount to substantial sums over the claimant's lifetime and, if it is proposed that the draft legislation now assumes that the claimant will have to take 'very-low risk' to achieve the 100% principle, it follows that appropriate advice should be paid for.

The GAD's report also assumes that some form of portfolio rebalancing or tactical asset allocation, for example *reduce levels of risk to 'bank' periods of good returns, increase levels of risk to recover from periods of poor returns, may take place in the portfolio(1).* It is therefore reasonable to assume that such a process would involve a higher level of investment management fees (associated with active management), and potential frictional costs associated with trading in the portfolio (bid-offer spreads, stamp duty on some assets, trading commissions and potential crystallisation of tax liabilities, depending on the wrapper used and the size of gains).

(1): Section 4.13 of the GAD report

We would strongly urge the Lord Chancellor to set an appropriate discount rate needs to be considered in net terms, taking account of a realistic assessment of the costs faced by an investor, if the 100% 'no-risk' principle is to be departed from.

In the absence of further detailed work on this issue, it is our view that as a minimum, the discount rate ought to be adjusted by *at least* 1.25% to cover investment charges and taxation, as being a realistic assessment of the costs associated with managing an investment portfolio.

In our experience, as advisers to personal injury claimants, investment advice costs can fall in the range of between 1.00% - 1.50% per annum. This would include fund fees, adviser costs, stamp duty and to make a broad allowance for the effects of taxation. We urge the Lord Chancellor to undertake more detailed analyisis of this issue, if the move towards the 'very-low risk' calculation is to be considered.

Periodical Payments

Given the substantial number of questions on periodical payment orders (PPOs), in the recent consultation, and bearing in mind how PPOs can in many high value cases eliminate investment and mortality risks for the greater part of personal injury awards, it is disappointing that no proposals resulted. In our view that is a missed opportunity. In our previous response, we proposed a practice direction that would direct the parties to consider periodical payments in suitable cases, with a view to widening the use of PPOs.

Therefore, we would strongly suggest that the possible uses of PPOs should be revisited as part of this process. For ease, we have excerpted part of our previous response as follows:-

> *Our opinion on how that situation might be improved, is that perhaps the CPR could be enhanced in this area by an appropriate practice direction/addition to the present practice direction. For example, prior to the implementation of PPOs by the Courts Act 2003, consideration of their precursor, structured settlements (which could not be ordered by the Court as the regime was consensual), was greatly assisted by such an arrangement. The practice direction at the time made it compulsory for the parties to consider structuring part of the award, in cases where the claimant was a child, or lacked capacity, and the future losses were in excess of £500,000. Expert input was therefore, the norm pursuant to that practice direction.*
>
> *A modern day equivalent might include all cases with future losses over, say £750,000. That amount would introduce expert advice into cases at the lower end of the band of cases in which PPOs might be appropriate. This could also result in future losses such as loss of earnings falling to be considered for a PPO. In our experience, such expert input is rarely sought in cases at the lower end of the possible PPO inclusive spectrum, with the likely consequence of lump sum settlements.*

Summary

In summary, Nestor believes that the suggested departure from the *Wells v Wells* no-risk 100% calculation principle is unfair to personal injury claimants. The draft legislation which supports the shift to 'low-risk' has been principally caused by the significant fall in the rate from 2.5% down to -0.75% which occurred in March 2017, which followed inertia and lack of action by previous Lords Chancellor over many years.

It is not possible to analyse the evidence used to support the 'low-risk' approach as this has not been disclosed. The analysis in support of the 'low risk' basis for calculating future loss damages within the GAD report and as presented within the draft legislation does, in our view, place personal injury claimants into the invidious position of having to expose their future loss damages to investment risk in order to achieve what is fair and correct in law, namely the 100% compensation principle. We do not believe that personal injury claimants are 'ordinary investors' and, in our view, should not be expected to take any risk in order to achieve full and fair compensation.

Lack of action by previous Lords Chancellor, and the fact that the 2.5% rate was wrong for so long, now appears to have given rise to a body of evidence that personal injury claimants do not actually invest their damages in ILGS post-settlement. There is no doubt that since the 2001 decision to set the rate at 2.5% that returns on ILGS have been unable to support the 100% principle using ILGS. This has meant that personal injury claimants have been forced to take investment risk, but this was not through their choice, rather by way of necessity. It now seems that this evidence is being used to support a means of resetting the parameters for the calculation of the discount rate in the future. This is, in our view, unfair.

The Lord Chancellor appears to have given great weight to the methodology and assumptions which were analysed within the GAD report. Access to this source evidence would be widely welcomed by practitioners. It appears that the conclusion that he has reached, which forms the draft legislation appears to conflict with the views of the Lord Chancellor's 2015 commissioned Expert Panel report which was recently affirmed by HM Treasury, during the most recent consultation.

The GAD report uses two example portfolios, namely A and B which have been constructed using evidence provided to them by the MOJ, but as yet, this evidence has not been made available. In our view, these portfolios expose personal injury claimants to unacceptably high levels of investment risk, and is not the correct starting point if the 100% calculation principle is to be upheld. The modelling used ignores a whole host of factors which could affect the returns on a personal injury claimants investments, as we have explained above.

There is limited information as to the analysis of the actual costs of investment advice and the effects of taxation, and it appears that very little detailed work has taken place on this vitally important area. The effects of charges and taxation has a significant impact on the longevity of the damages award, and is a key component when setting a fair rate, if there is going to be a departure from the no-risk *Wells v Wells* principle. On any view, if there is such a departure, the rate would need to be reduced by *at least* 1.25% (rather than the 0.5% assumption used in the GAD report), to reflect the true cost of investing and taxation.

The Lord Chancellor has assumed that personal injury claimants ought to invest in 'low risk diversified portfolios' when setting the rate. In our view, this definition is subjective and assumes that personal injury claimants benefit from proper regulated FCA approved person advice, which, pre-settlement is sporadic at best. Should it be determined that personal injury claimants must take some risk to achieve the 100% compensation principle, then it stands to reason that every claimant needs to benefit from regulated FCA approved person advice as a matter of course in all personal injury claims. Without this authorised advice, there is a real danger of personal injury claimants being significantly undercompensated, under the proposed low-risk draft legislation.

Irrespective of the actual costs of investment advice, it is our view that personal injury investors are not 'ordinary investors'. Proper investment and financial advice costs money, and if the Lord Chancellor is proposing a move away from the no-risk principle, then we believe that legislators ought to seriously consider the ablity for a personal injury claimant to be able to recover the lifetime costs of such advice within their claim. It is our view, that if a claimant is compelled to take advice, just to achieve the 100% principle, then they ought to be able to recover the costs of such advice from the tortfeasor.

We accept that the Lord Chancellor is under an obligation to strike a balance between parties to the litigaton, and we also accept that these financial decisions can have long-term effects upon the insurance industry, the NHS and the MOD, as the majority payers of personal injury damages awards. We understand these obligations but would remind the Lord Chancellor that any change to legislation for future loss personal injury damages needs to continue to reflect the basic 100% compensation principle. We are extremely concerned that the draft legislation put forward will end this basic principle. The evidence relied upon is at best problematic and open to interpretation, and at worst, incorrect, and will likely result in many personal injury claimants being under compensated, if as suggested, the rate increases to within the range 0.00%-1.00%.

We would therefore urge the Lord Chancellor to reconsider the proposal to depart from the *Wells v Wells* 100% principle, or at the very least reconsider the evidence used to support the *very-low risk* principle.

Nestor Financial Group Limited

11th October 2017