Ministry of Justice Consultation
Personal Injury Discount Rate - How It Should Be Set In Future
Response By Nestor Financial Group Limited
May 2017

Introduction

1) Nestor is an Independent Financial Advice firm, specialising in personal injury and clinical negligence work. This takes the form of expert witness work in relation to periodical payments, advising on and managing post-settlement investment strategies for claimants and establishing Personal Injury Trusts where appropriate.

2) Expert witness instructions are mostly from claimant solicitors, with about 10% being defendant instructions. We receive in total around 150 expert witness instructions each year from legal practices throughout the country.

3) We advise on the establishment and monitoring of investment strategies for many of the UK's well-respected Professional Deputies, as well as acting directly for lay clients and/or their Deputies/Trustees. Nestor is based in the North-West of England and has clients across the whole of the UK. We have funds under management totalling approximately £500 million, plus cash accounts totalling over £100 million. Our average sized investment portfolio is around £700,000.

4) In the field of personal injury IFAs, Nestor is a leading specialist in advising on catastrophic injury cases.

5) Nestor is in support of the long overdue reduction in the discount rate applied in March 2017.

6) As IFAs, the directors at Nestor build long-term professional relationships with our claimant clients post-settlement, and we see evidence of the impact that sustaining serious injury has on their quality of life and that of family and friends. In most cases, they are unable to work. Also, their family members are often unable to work, having spent time to care for their loved one, with many years out of the workplace. Our clients' complex needs impact on every area of their lives. There is not one client that would not give the money back if they could have their health and mobility returned.

7) The purpose of the compensation is to put the claimant back into the position they would have been but for the accident or negligence. The damages are calculated to pay for past, immediate, and specific future needs. For those that have been unable to receive (or where defendants have been unwilling to pay) appropriately indexed periodical payments for future losses, the lump sum calculation has undercompensated personal injury survivors for most of the period since 2001. The calculation of the lump sum based on a discount rate of 2.5% has disadvantaged claimants during that period. In our experience, claimants simply want a fair and reasonable sum of money with which to meet their reasonable and predicted expenditure.

Consultation Response

Q1: Do you consider that the law on setting the discount rate is defective? If so, please give reasons.

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.

Q2: Please provide evidence as to how the application of the discount rate creates under or over compensation and the reasons it does so.

In the current investment climate, it does not follow that a claimant is fully protected against movements in the Retail Prices Index if they invest in ILGS even with a discount rate at minus 0.75%. The claimant would only be fully protected if they purchased a portfolio of ILGS which matched their actual cashflow requirements which it is not possible to do so with ILGS, as:-

a) It is not possible to predict the actual date of death of the claimant, and

b) The cashflow requirements of a claimant are unlikely to follow an inflation index closely, as they will be influenced by the individual circumstances and health of the claimant, and

c) Many of the claimant's future costs will be wage related.

There are currently 27 ILGs in issue (including two ILGs which mature in the same year). This is illustrated by information on the website of the UK Debt Management Office, which shows the nominal amount of ILGs in issue for each redemption year as at 1st March 2017, and can be found at the following link:

http://www.dmo.gov.uk/index.aspx?page=gilts/indexlinked

There are many individual years in which no ILGS mature, and it should be noted that no ILGS mature after 2068, which means that it is not possible to match the exact cashflow requirements of a claimant with ILGS.

Current market pricing of ILGSs does not support the reduced discount rate. ILGSs currently offer real yields of -2.45% (for the 2022 maturity) and -1.60% (for the 2046 maturity). The current range of ILGSs (going out to 2068) offer real yields in the range -1.6% to -1.8%. It is therefore clear that an investment strategy relying solely on ILGSs will fail to meet a claimant's long-term needs, even putting aside the very substantial effects of earnings related care cost inflation (which is not factored into the discount rate) and the costs of managing such a strategy.

Today's yields on ILGSs are certainly less negative than they were in the third quarter of 2016, but are still close to the lowest ever seen for this asset type. It is therefore not clear that expecting a personal injury investor to simply build a portfolio of ILGSs and hoping for the best is prudent financial advice.

Looking at historic real yield data for the generic 10-year and 30-year maturity ILGSs produces a three-year simple average gross real redemption yield of -0.89% and -0.73% respectively. The methodology used to calculate the discount rate has been applied correctly to arrive at the minus 0.75% rate, however, to reiterate, it leaves a number of issues for claimant investors to contend with:-

- Current real yields today are significantly below the three-year rolling average as at end of Dec 2016 - with the 10-year at -1.86% real and the 30-year at -1.55% real. Clearly, these will not be effective long term solutions for an award based on achieving an outcome of -0.75%.

- The simple average will change quite dramatically over time, and especially when 2014 drops out of the data: assuming that the yield doesn't move from here, the 3-year simple average at the end of 2017 will be -1.85% for the 10-year linker and -1.54% for the 30-year linker. A system that makes awards based on the 3-year rolling average may need to update the discount rate quite frequently to keep up with changed market conditions.

- Implicitly, using the 3-year rolling average to calculate the discount rate embeds an assumption that yields will revert to that average over time. A reversion of today's yields to the levels implied by the Lord Chancellor would result in ***significant capital losses*** for index linked gilts. For example, if the current generic 10-year linker (UKI 0.125% March 2026) reverted immediately from its yield today (-1.86%) to the 3yr average calculated of -0.89%, that would result in a fall in value of around **8.5%**. For the generic 30-year (UKI 0.125% 2046), a reversion from today's yield of -1.55% to the calculated 3-year average of 0.73% would mean a fall in value of around **21%**.

In summary, even if it were the case that an investment portfolio made up of ILGSs with 5-years' plus maturities would meet lifelong needs, there is a significant risk that claimants would suffer capital losses over the life of the Gilt. This is due to significant fluctuations in the real yield, and has a significance for personal injury claimants, if they need staged capital withdrawals, to replace equipment etc. If such capital is needed at a time when real yields are higher, then any withdrawal may be extremely destructive for an ILGS portfolio's long-term earnings capacity. Whilst it is considered that ILGSs are low-risk assets, ILGS prices are extremely sensitive to shifts in the real yield.

In reality, while Nestor is very supportive of the discount rate reduction, and believe that it is long overdue, claimants should not be under any illusion that adopting a simplistic 'basket of ILGs portfolio' approach to investing is free of danger or risk. Adopting a cautious and low risk approach is usually advisable, but investing solely and directly in ILGs is impractical and unwise. Such an approach is unlikely to be able to meet a claimant's needs, and even more unlikely to build up reserves to guard against mortality risk, or to help with restoring any deficit arising from purchasing accommodation in a negative discount rate scenario.

Regardless of the ILGs market and its difficulties, the welcome fact is that the reduced discount rate has reduced the pressure on long term gross investment returns. Under the 2.5% discount rate, in order to meet wage related expenses, underlying investment returns before charges and tax needed to be in the region of 9-10% per annum. Utilising the -0.75% discount rate means underlying investment returns now need to be more like 5.5 to 6.5%, which ought to be achievable for a cautious investor.

Q3: Please provide evidence as to how during settlement negotiations claimants are advised to invest lump sum awards of damages and the reasons for doing so.

In our experience, claimants are not advised at all how to invest lump sum damages during settlement negotiations. In circumstances where Nestor is instructed to act as expert witness in relation to periodical payments, it would be considered a conflict of interest to give specific advice on how to invest a lump sum. IFAs such as Nestor compare the options of periodical payments versus lump sums on a generic basis pre-settlement for Court purposes.

In cases being settled purely by lump sum, in our experience, IFAs such as Nestor are approached for investment advice only after the claim has settled. Solicitors and Barristers are not authorised or regulated to provide investment advice at the time of settlement and IFAs are not instructed to discuss investment matters, even on a generic basis, with claimants prior to settlement. In our experience, investment considerations often come as a shock, and are perceived as another 'problem' to deal with by claimants post-settlement, especially in situations where they do not have any ongoing assistance from a Court of Protection appointed Professional Deputy or Professional Trustee. In Nestor's experience, many claimants do not have any experience of investing money and they are worried and daunted by the responsibility of taking investment decisions.

At present, the system and the law does not allow for costs of investment advice to be recovered either prior to settlement (unless it is to cover the cost of periodical payment advice), or post-settlement. We believe strongly that this is something that ought to be addressed in order to improve understanding and outcomes for claimants.

Nestor is also of the view that lawyers settling claims ought not to be allocating damages between periodical payments and lump sums without the assistance of expert IFA advice.

Q4: Please provide evidence of how claimants actually invest their compensation and their reasons for doing so.

At Nestor, we have been consulting with external experienced fund managers currently managing personal injury damages awards for our clients. We use a number of specialist investment managers, given our independent status. Most of our personal injury clients' portfolios are very cautiously invested, an approach that we have been championing for many years, as we recognise that personal injury investors are not *ordinary investors.*

The issue we needed to address at first instance was this: Given the reduction in the discount rate, why is it not sensible to invest claimants' awards into a portfolio of Index Linked Government Stock (ILGS)? After all, that is the essence of the calculation.

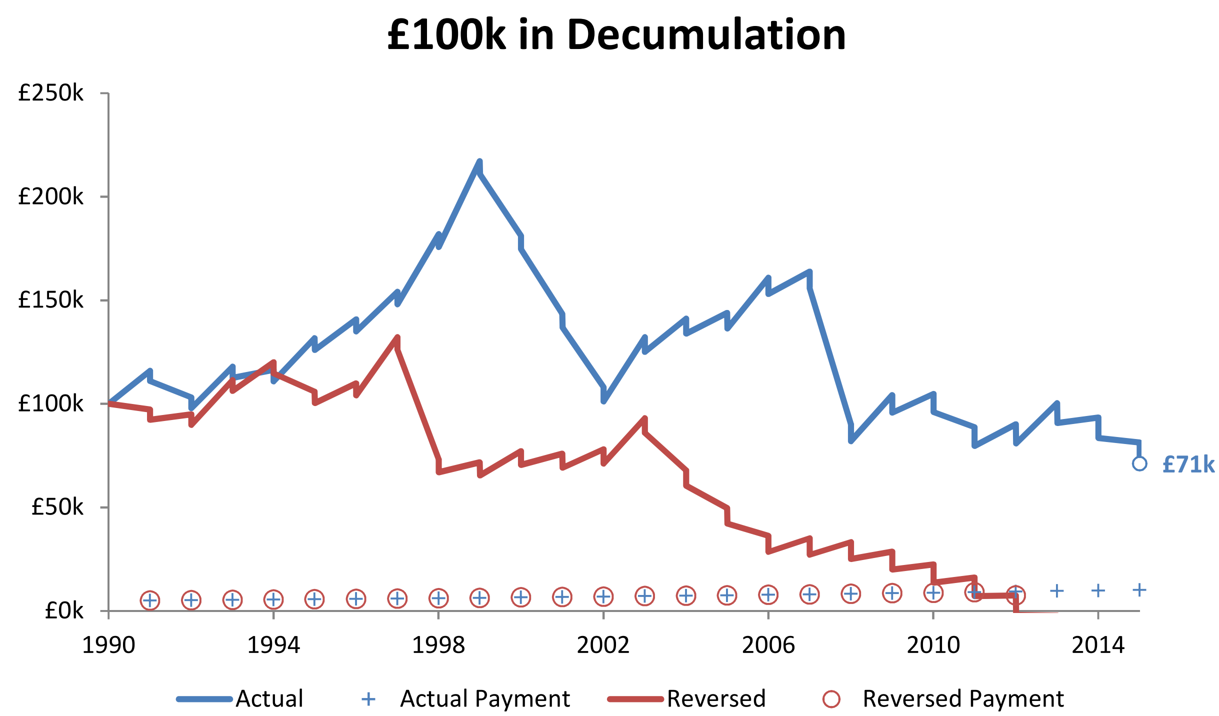
After due consultation and consideration, and for all the reasons set out above, it is our view that larger awards based on the new discount rate will still not eliminate the effects of long-term inflation risk. This is because the new discount rate is still higher than the real yields available on ILGS. Further, there is also the additional risk that care and other wage related costs will rise faster than inflation as measured by the Retail Price Index. ILGSs will never be able meet wage cost inflation. Also, lump sum awards will always carry mortality risk, a crucial factor somewhat lost in the recent excitement.

It is still therefore desirable that personal injury investors aim to target a return greater than inflation if they want their damages to last, in the context of larger lump sum awards. Investment portfolios made exclusively of direct holdings in ILGSs are far from risk-free, and will potentially be subjected to extreme price volatility, given the fact that ILGSs have high current valuations. Future personal injury claimants will get greater lump sum awards and, in theory, those awards ought not to be invested in risk-based assets to get greater returns. However, the very notion that personal injury claimants will be able to invest entirely in a portfolio of ILGs with maturities of at least 5-years is, at best, impractical.

There are many potentially suitable investment strategies that could be adopted by claimants. At Nestor, we have a range of solutions for our clients, and recommend an investment strategy only when we have established the client's needs, as well as attitude to risk. There is no such thing as one right answer. All of the external investment managers recommended by Nestor must meet our strict due diligence criteria, and are subject to quarterly scrutiny from Nestor's Investment Committee.

There are many risks faced by personal injury investors due to the requirement to drawdown on their investments over long periods of time. This is known as decumulation. Investors are subjected to random and unpredictable fluctuations in market returns. These can be felt acutely when there is a need to decumulate capital to meet ongoing expenditure needs.

The graph below shows an example of £100,000 invested, performance being in line with the MSCI World Index (source Morgan Stanley). There is an assumption of annual withdrawals at £5,000 per annum, increasing by 3% each year. The blue line shows the actual returns experienced between the years 1991 to 2015. If, however, it is assumed that the annual returns occurred in *reverse order,* we can see the effect that that would have had on the fund, with it being totally depleted in the year 2012. Remember, investors have no control over market conditions; the only thing that can be influenced is where the money is placed.



Perhaps one of the most high-profile and best-known funds in this market is the Personal Injury Fund, run by Seven Investment Management. The fund, an Open Ended Investment Company (OEIC), was incepted in 2009 and all information relating to returns is in the public domain. It terms of risk, it sits towards the bottom end of the cautious risk profile, at times being on the cusp of a defensive strategy. The Personal Injury Fund is used for some but by no means all of Nestor's clients, and it is important to document that it is not a one-size-fits-all solution. It may, however, shed some light on actual historic returns for cautious investors. The 5-year performance to the end of December 2016 resulted in *nominal* returns of 4.5% per annum, after internal fund charges and platform charges. If this figure is converted into *real* net returns, it is necessary to take off the following:-

- RPI inflation - taking historic trends this would be 2.5% per annum.
- IFA charges - say 0.5% per annum.
- Tax - as a proportion of the lump sum, say, 1% per annum.
- Wage inflation if future losses are earnings based - the Financial Conduct Authority assumes a difference of 1.5% per annum between price inflation and wage inflation for preparing financial projections (Source COBS 13 Annex 2/4).

To put this in context, the 5-year performance results in a real net rate of return of 0.5% per annum for price based RPI future costs and a real net rate of return of -1% for wage related future costs.

It is essential for claimants to retain some of their lump sum in cash to cope with unexpected events and to draw down upon, particularly in cases where no periodical payment is received. The cash fund acts as a drag on portfolio performance, which needs to be considered as part of the long term financial strategy.

Q5: Are claimants or other investors routinely advised to invest 100% of their capital in ILGS or any other asset class? Please explain your answer. What risks would this strategy involve and could these be addressed by pursuing a more diverse investment strategy?

Please see the answer to question 2 above. Nestor's clients do pursue more diverse investment strategies to deal with the shortcomings of the discount rate, with most implementing a cautious approach to investment risk, resulting in modest upside returns but with limited downside when markets move against them.

In addition, it may seem counter intuitive that, on the one hand, we agree with the *Wells* methodology but, on the other, accept that it is sensible to invest in mixed asset portfolios - not simply a basket of gilts. The reality is that the law that is not defective, but there is a lack of financial solutions available to claimants to meet the minimal/no risk investment objectives necessary to meet their lifetime requirements, as quite properly targeted by the law.

There is a clear mis-match with regard to theoretical and actual yields at given times, and we have attempted to address this with solutions contained later in response to other questions (3 yr reviews/0.5% triggers etc.) PPOs alleviate many of the issues if used more readily in appropriate circumstances (again we've outlined our views on this elsewhere) and, of course, a thriving annuity market may well assist further in this regard for all parties to the litigation. Mixed portfolios will also continue to have a place, as there is no doubt that claimants' freedom to choose should not be compromised.

The solution that may well best meet the *Wells* objective is quite simply to bolster the low risk investment arena/gilt market, or that relating to annuities, with specialist and bespoke gilt strips available only to catastrophically injured investors. That approach would create a low risk investment environment, with no or minimal mis-match, and can be advised upon by specailists with an understanding of the bespoke needs of personal injury victims. This assists in protecting those most vulnerable from the shark infested waters of the wider financial services industry, in particular, advisers who may simply just 'dabble' and have no long-term experience of the holistic advice needed for claimants, their professional support team and wider family networks.

Q6: Are there cases where PPOs are not and could not be made available? Are there cases where a PPO could be available but a PPO is offered and refused or sought and refused? Please provide evidence of the reasons for this and the cases where this occurs.

In our role, both as providers of advice on the format of award pre-settlement and post-settlement investment advice, we see many examples of cases where a PPO would have been viable, but with the case settling on a lump sum basis. The usual reason for this is the defendant's insurer refusing to negotiate on the basis of settlement inclusive of a PPO. Defendants appear to exploit litigation risk opportunities to force the claimant's hand as regards the format of award. It is not unusual to see this approach even in cases whereby Court Approval would be required.

In our view, such an approach is based upon the insurer's reserving position – a purely commercial approach. If a PPO is reserved on the basis of 0.5% or 1%, clearly, a lump sum award was preferable to defendants on a commercial basis, when the rate was 2.5%. This contrasts of course to the PPO preference of non-commercial defendants such as the NHSLA, and MoD. Now that the rate has reduced, reserving at 0.5% or 1% now makes PPOs more attractive to defendants.

Therefore, since the discount rate changed, the reserving position has been reversed. Defendant representatives on various discussion panels post change, and to which we have been party, have confirmed this point. In other words, indications are that PPOs may now be preferable to insurers

Q7: Please provide evidence as to the reasons why claimants choose either a lump sum or a PPO, including where both a lump sum and a PPO are included in a settlement.

In our experience, reasons vary from the approach of the defendant (see answer to Q6), to the quality of advice obtained. Although the relevant practice direction specifically sets out that expert advice is one of the factors to be taken into consideration by the Court in relation to the award's format, (thereby indicating the importance of such evidence and that the cost of such expert input should be a recoverable cost), not all claimants receive such advice. Those receiving appropriate advice may well be in the minority.

Often in our view, any such advice is obtained late in the claim which, to some extent, is understandable, particularly where primary liability remains live - discussing format of the award at that stage may cause difficulties with client management - particularly if the eventual award was much less than that used to generate discussion over PPOs. That said, claimants wherever possible, should receive advice, and at as early a stage in the claim as convenient.

Q8: How has the number of PPOs changed over time? What has driven this? What types of claims are most likely to settle via a PPO?

We do not have access to overall statistics to demonstrate the number of cases settling inclusive of PPOs. However, developments (usually case-law driven), since the start of the statutory regime in 2005, have largely cleared the way for greater usage. The *Thompstone* cohort of cases clarified the indexation issue, whereby PPOs for care were linked to ASHE 6115, an earnings based measure. Those cases opened the door to consideration of other future losses to be met by PPOs, particularly lost earnings, and deputyship costs. PPOs for care/case management however, are the norm, with the latter two heads of future loss, something of a rarity in terms of PPOs, outside of the context of public body defendants such as the NHSLA.

The vast majority of cases including a PPO as part of settlement are those of catastrophic proportions. In other words, very serious injury, with lifelong consequences. Also, cases involving a liability reduction, are less likely to involve expert advice about the format of the award. Traditional thinking amongst legal practitioners is often that a lump sum award is usually preferable in such cases. This may be correct in claims with a very substantial discount, but such opinion appears to be derived from the misconception that a lump sum might be invested with the result that the shortfall could be reduced over time. The reality is, that large shortfalls will not be reduced as a result of investment returns based on *caution*. The effect therefore, can be that investment risk is introduced into a reduced value claim, often unnecessarily. By contrast, a PPO can provide certainty in such situations and appropriate expert advice would assist with evaluation on a case by case basis.

Q9: Do claimants receive investment advice about lump sums, PPOs and combinations of the two? If so, is the advice adequate? If not, how do you think the situation could be improved? Please provide evidence in support of your views.

We cannot comment on the quality of advice provided by non-specialist advisers. In our experience, however, non-specialist financial advice is probably quite rare. Occasionally, we have sight of advice provided by others in our field, particularly if they are instructed by the other party in the litigation. Competent advisers in our field of expertise, number very few, and as discussed above in our response to Q7, probably a minority of claimants are advised appropriately.

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.

Q10: Do you consider that the present law on how the discount rate is set should be changed? If so, please say how and give reasons.

It is our view that the methodology and reference to the 3-year simple average gross real redemption yield (AGRRY) on ILGS is a fair and appropriate way to calculate future loss personal injury damages. Irrespective of where a personal injury claimant actually invests their future loss damages, we believe that reference to AGRRY on ILGS is a fair and appropriate starting position for the calculation of future loss damages awards for personal injury claimants.

It is also our view that the current arrangement whereby the Lord Chancellor retains the power under the Damages Act to set the discount rate according to AGRRY ILGS is appropriate, subject to an alteration in the powers afforded to her.

It is our view that the Lord Chancellor ought to be required to consider the AGRRY on ILGS on a more timely and fixed basis, referring to information supplied to her by the DMO on a more formalised basis, *say* every two years. Undertaking such a biennial review would ensure that the discount rate remains more in line with AGRRY on ILGS, and would be fairer for all parties concerned. These reviews ought to be at a fixed point, using AGRRY ILGS data from the period 3 to 6 months prior to the review. Once this data is analysed, the Lord Chancellor should then be obligated to alter the rate if required, one month post-completion of the review, using relevant and up to AGRRY ILGS data. The rate announcement ought to be on a fixed date every two years, or, as necessary in circumstances whereby the AGRRY on ILGS alters by a margin of more than 0.5%, due to exceptional economic and financial conditions.

We see no reason to alter the current law which gives the power to set the rate to the Lord Chancellor. However, our view is that lack of adequate and ongoing scrutiny of the AGRRY on ILGS, and the significant delays in altering the rate that we have witnessed over the last 16 years have been unfair to personal injury claimants.

Q11: If you think the law should be changed, do you agree with the suggested principles for setting the rate and that they will lead to full compensation (not under or over compensation)? Please give reasons.

It is our view that the principles of using AGRRY on ILGS as laid out in *Wells et al* provides a fair and reasonable method for calculating future loss personal injury damages.

Q12: Do you consider that for the purposes of setting the discount rate the assumed investment risk profile of the claimant should be assumed to be:-
a) Very risk averse or "risk free" (Wells v Wells)
b) Low risk (a mixed portfolio balancing low risk investments)
c) An ordinary prudent investor
d) Other
Please give reasons.

It is our view that the principles as set out in *Wells et al* is a fair and reasonable starting point for calculating future loss personal injury damages awards. We believe that any deviation from the *Wells* principles of using AGRRY on ILGS may lead to under compensation for personal injury victims. We do not believe that personal injury claimants should have to to expose any of their future loss damages to any investment risk, in order to recover full compensation.

Q13: Should the availability of Periodical Payment Orders affect the discount rate? If so, please give reasons. In particular:-

- **Should refusal to take a PPO be taken as grounds for assuming a higher risk appetite? If so, how big a difference should this make to the discount rate?**

- **Should this assumption apply in cases where a secure PPO is not available?**

The availability of PPOs should not affect the discount rate.

Theoretically, PPOs are available in every case where future losses exist. The choice to pursue a PPO is for the claimant and his/her legal representatives to make in the circumstances of each case, preferably with recourse to expert financial advice. This freedom to choose, coupled with the ability of the Court to impose a PPO where agreement cannot be reached, to or approve an agreement where it is of great importance to ensure settlements are focused on meeting claimants long term needs as best can be predicted. Catastrophically injured people should not have any freedom of choice removed simply because of the seriousness of their injury.

Defendants and their insurers have to settle cases on the best financial terms for themelves regardless of the claimants best interests. That is the nature of litigation. This may include a PPO or it may not. Claimants should not be disadvantaged or restricted because of this approach.

A refusal to take a PPO should not be general seen as an indication of the claimant having a greater appetite for risk. Most claimants have no investment experience, and appetite for risk is therefore simply irrelevant at the stage of the claim, where PPOs/lump sums *should be* in the process of being considered properly.

As stated above, many claimants are not in the fortunate position of having received expert financial advice on how their award could be structured in terms of lump sum/PPO. Also defendant insurers (until very recently), generally favoured lump sum awards, so would often refuse to negotiate on a PPO basis. Such factors which may result in lump sum awards, should not raise a presumption of higher risk appetite. It follows therefore, that availability of PPOs should have no bearing on the discount rate, whether a PPO is actually possible, or not.

In other cases, claimants might choose to accept a lump sum award for sound and proper reasons, and should not be penalised by the application of a higher discount rate, based on an unworkable and illogical presumption as to investment risk appetite.

Q14: Do you agree that the discount rate should be set on the basis that claimants who opt for a lump sum over a PPO should be assumed to be willing to take some risk? If so, how much risk do you think the claimant should be deemed to have accepted? Please also indicate if you consider that any such assumption should apply even if a secure PPO is not available. Please give reasons.

There is no logical link between claimants seeking lump sum awards rather than PPOs, so the discount rate should not be altered on that basis.

Q15: Do you consider that different rates should be set for different cases? Please give reasons. If so, please indicate the categories that you think should be created.

It is our broad view that one discount rate for all personal injury claimants is the most sensible and clear method for future loss damages. There is a risk that if differing rates were to be set for different types of personal injury claimants that this may lead to unfairness in the system. As we have stated, we believe that greater use of Periodical Payment Orders for future loss damages ought to be promoted, rather than having different discount rates for different types of claimants.

One caveat to that broad approach, is that different discount rates *might* be applied to earnings based losses as opposed to those linked to prices. Such an approach has attracted judicial support in lump sum awards in ihigh level, influential decisions in Guernsey (*Hlemot v Simon* , [2012] UKPC 5, and Ireland (*Russell v Health Service Executive* Appeal No. 2015/49). Differentiating losses on the basis of earnings/price inflation, would bring the lump sum regime in line with that inclusive of PPOs.

Q16: Please also indicate in relation to the categories you have chosen whether there are any special factors that should be taken into account in setting the rate for that category.

Save for the above at 15, we do not believe that there ought to be different discount rates set for different cases.

Q17: Should the Court retain a power to apply a different rate from the specified rate if persuaded by one of the parties that it would be more appropriate to do so? Please give reasons.

It is our understanding that this power already exists within the Damages Act, although this power has not been widely exercised. We believe that retaining this power in the provisions of the Damages Act is acceptable.

Q18: If the court should have power to apply a different rate, what principles should apply to its exercise?

We believe that the current powers as laid out in the current Damages Act are acceptable.

Q19: Do you consider that there are any specific points of methodology that should be mandatory? Please give details and reasons for your choice.

Please refer to previous responses at Q16 to 18.

Q20: Do you agree that the law should be changed so that the discount rate has to be reviewed on occasions specified in legislation rather than leaving the timing of the review to the rate setter? If not, please give reasons.

As stated in our response at Q10, it is our view that the Lord Chancellor ought to be compelled to undertake more timely and fixed-date reviews of the discount rate. It is our view that the Lord Chancellor ought to formally review and announce the discount rate every two years, or more frequently, if market and financial conditions alter the AGRRY on ILGS by a margin of greater than 0.5%.

Yield data, including AGRRY on ILGS is widely available, and it is our view that the Lord Chancellor ought to be provided with such data from the DMO on a timely basis, in order for a formal biennial review to be undertaken. These future dates ought to be fixed, in order to provide certainty, and the Lord Chancellor ought to be required to publish the review on a fixed date, every two-years, or more frequently if economic and financial conditions move the AGRRY on ILGS by greater than 0.5%.

Q21: Should those occasions be fixed or minimum periods of time? If so, should the fixed or minimum periods be one, three, five, ten or other (please specify) year periods? Please give reasons.

It is our view that such reviews should occur every two years, or more frequently for the reasons as stated at Q20 above. We believe that two years is an appropriate time between reviews, as it affords claimants the certainty that the discount rate is considered on a timely and consistent basis. Having such a biennial review, also allows personal injury practitioners and the Courts, sufficient time between reviews to progress and conclude cases.

It is also more likely that, if reviews take place on a fixed date, there would be less movement on any rate change, as more frequent observations of AGRRY on ILGS would be fairer for both parties. In the light of the recent and dramatic rate change from 2.5% down to *minus* 0.75%, it is clear that more active and frequent consideration of the AGRRY on ILGS would likely ensure that future rate changes should not be so unsettling.

Q22: When in the year do you think the review should take effect? Please give reasons.

It is our view that the review of the discount rate ought to be announced at around the same time as the Chancellor of the Exchequers Autumn Budget, on a biennial basis.

Q23: Do you agree that the rate should be reviewed at intervals determined by the movement of relevant investment returns? If so, should this be in addition to timed intervals or instead of them? What do you think the degree of deviation should trigger the review?

As referred to in our answer at Q20, in addition to the two yearly reviews which the Lord Chancellor is required to undertake and also to publish the resulting rate, a mechanism ought to be put in place whereby if the DMO report that the three-year simple average gross real redemption yield on ILGS, (ex-ILGS with less than five years to maturity) has fallen by greater than 0.5% within that two year fixed review period then it is our view that the Lord Chancellor ought to be compelled, on a exceptional basis, to review and announce the altered discount rate. This means that if economic and financial conditions change dramatically over a shorter than 2-year period, that the Lord Chancellor is further obligated to review and alter the rate.

Q24: Do you agree that there should be a power to set new triggers for when the rate should be reviewed? If not, please give reasons.

We refer to our response in Q23. If there is movement in the AGRRY on ILGS of greater than 0.5% within the two-year review process, then the Lord Chancellor ought to be afforded the power to alter the rate.

Q25: Do you consider that there should be transitional provisions when a new rate is commenced? If so, please specify what they should be and give reasons.

It is our view that provided that the Lord Chancellor reviews the rate every two years, on a fixed basis, or in exceptional economic conditions as identified in Q23. Therefore there would be little or no need for any transitional provisions.

Q26: Do you consider that the discount rate should be set by:-

a) A panel of independent experts? If so, please indicate how the panel should be made up.

It is our view that the power the set the discount rate ought to remain with the Lord Chancellor under the provisions of the Damages Act.

b) A panel of independent experts subject to agreement of another person? If so, on what terms and whom?

It is our view that should the Lord Chancellor should always seek assistance from experts on the setting of the rate, subject to the power of actually setting the rate to be retained by the Lord Chancellor.

Would your answers to the questions above about a panel differ depending on the extent of the discretion given the panel? If so, please give details.

See answer Q26(b).

c) The Lord Chancellor and her counterparts in Scotland or another nominated person following advice from an independent expert panel? If so, on what terms?

See answer Q26(b).

d) The Lord Chancellor and her counterparts in Scotland as at present?

See answer Q26(b)

e) Someone else? If so, please give details.

See answer Q26(b)

Q27: Do you consider that the current law relating to PPOs is satisfactory and does not require change? Please give reasons.

The present law as regards periodical payments is satisfactory, in terms of statute, CPR and developments through case law since the commencement of the PPO regime in 2005. That said, the possibility of a PPO as part of settlement is not always investigated or considered with the assistance of appropriate expert evidence, or at all. Also, defendant insurers are often resistant to PPOs. These points have already been made above. As previously stated, a practice direction making proper consideration of PPOs mandatory, with advice obtained from approved, specialist advisers in all cases inclusive of significant future losses, may be one of the ways of encouraging greater uses of that type of award.

Q28: Do you consider that the current law relating to PPOs requires clarification as to when the court should award a PPO? If so, what clarification do you consider necessary and how would you promulgate it?

No clarification is required, other than greater focus which may be achieved through a practice direction as discussed above. However, aside from cases where defendants are unwilling to offer PPOs, there are various categories of cases where PPOs are simply not available. Examples include claims where insufficient insurance levels are involved, which is not unusual in relation to employers liability (EL) and public liability (PL) policies. Motor policies do not contain limited indemnity levels, so such problems do not apply, however, some policies pre-dating 1st January 2004, and involving Lloyds Syndicate Members, cannot be regarded as secure for the purposes of a PPO, for technical reasons.

A potential problem area is in cases where the Motor Insurers' Bureau (MIB) is the defendant. Initial PPO guidance provide by the Department for Constitutional Affairs, at the very outset of the PPO regime, viewed the MIB as unlikely to be secure for self funded PPOs.

Medical indemnifying bodies such as the Medical Defence Union and The Medical Protection Society, were viewed with similar uncertainty. Case law exonerated the MIB - in *Thacker v Steeples* (unreported), based on that body's longevity, its ability to increase contributions from its members to meet higher levels of liability, *and,* its existence due to the UK's obligations to the EU to provide such a scheme, the court found the MIB to be reasonably secure. Clearly, the third limb of that judicial analysis is about to disappear, so the MIB, may be soon to return to the company of the medical indemnifying bodies, in not being regarded as secure for the purposes of PPOs.

The Lloyds cases as outlined above, are now very few in number, due to passage of time, but problems awarding PPOs in cases where employers' liability and public liability policies, remain. Similarly, medically indemnifying bodies and possibly the MIB, are problem areas, where defendants are not automatically secure in tems of fulfilling the requirements of the Damages Act.

Potential answers include increased statutory minimum cover for EL and PL policies. We understand that such a lower limit for employers' liability policies is presently set at £10,000,000. In any event, given the effect of the reduced discount rate, such levels of indemnity may need to be reconsidered. Without doubt there must be sufficient cover to meet the accumulating cost of a high value PPO, to be paid over a lifetime of possibly several decades, therefore indemnity levels need to be considerably greater.

Another approach might be to allow claimants to purchase an annuity with part of their award. Presently, no such annuities are available which are capable of providing earnings based inflation proofing. A vibrant annuity market, was envisaged by the Department for Constitutional Affairs, in its guidance document, released at the very start of the PPO regime. Sadly, that market did not exist, which is unfortunate, as problem defendants as outlined above, would have had the option to use the annuity route, so as to provide PPOs on a secure basis. It follows that stimulation of an appropriate annuity market, may assist in the availability of those products, thus widening the availability of PPOs.

Should annuities become available, claimants with awards which have already settled on a lump sum basis by way of necessity, may be given the option to purchase an annuity after the event, thereby using an appropriate part of remaining captal, effectively to purchase a PPO. As the law stands presently, to ensure tax freedom, any annuity purchase would need to be made at the time of settlement. The law in this area would require relaxation, so as to allow claimants to make such a purchase, say within a reasonable period post settlement, should suitable annuities become available. That approach should allow the tax freedom aspect of the purchase, to be protected for a certain period, or preferably, indefinitely.

In short, the availability of appropriate annuities is desirable, and would provide options for both parties to the litigation, hopefully resuling in the wider use of PPOs.

Q29: Do you consider that the current law relating to PPOs should be changed by creating a presumption that if a secure PPO is available it should be awarded by the Court? If so, how should the presumption be applied and on what grounds could it be rebutted?

Please see the answers above at 10, 28 and 29. Expert advice would be a principal factor in rebutting such a presumption hence, in our view, availability of such advice at an appropriate stage in the claim, would nullify the need for such an approach which might be considered by some as heavy handed. In any event, the Court already has the power to impose a PPO against the will of the claimant.

Q30: Do you consider that the current law relating to PPOs should be changed by requiring the court to order a PPO if a secure PPO is available? If so, what conditions should apply?

We do not consider that such a change is required. Please see our reasoning as above at 10, 28 and 29.

Q31: Do you consider that the cost of providing PPOs could be reduced? If so, how?

This question is probably outside our area of expertise, and is likely within actuarial territory. However, the court, particularly *Thompstone* at both first instance and Appeal level, made it clear that the perceived extra cost to defendants in providing earnings linked PPOs, was not an argument that could be considered in weighing whether a PPO was to be awarded.

Q32: Please provide details of any costs and benefits that you anticipate would arise as a result of any of the approaches described above.

We support greater use of PPOs. If proper consideration can be made a regular or compulsory feature of the litigation, involving appropriate expert evidence, (the cost of which is met by the defendant), there would be a benefit to claimants. The CPR presently requires the court to provide an indication to the parties, *as soon as practically possible,* as to the likely format of the award. That indication, based to some extent on expert input, which, realistically speaking, might not be available until late in the day in terms of the timetable, would focus the minds of the parties. That approach would make it more risky for defendants to refuse to negotiate in terms of PPOs; and also risk would attach to a stubborn claimant, in resisting a PPO against advice.

Q33: Please provide any evidence you may have as to the use or expected use of PPOs in the light of the change in the rate and more generally.

Initial indications since the rate change, are that defendants may be more willing to negotiate on the basis of PPOs. This has been covered above, but is seemingly based on commercial considerations, principally reserving, which has made PPOs more financially attractive to insurers. On the other hand, some claimant practitioners are taking the view that the advantages of PPOs (in short, extinguishing investment and mortality risk on a secure, tax free basis), have been considerably eroded, with the balance shifting back somewhat, in favour of much larger lumps sum awards.

It is still very early post change. Other factors, such as the negative impact of the change on accommodation claims, are still to be clarified. Patterns will begin to emerge over the coming months, once the outstanding difficulties (principally accommodation), have been aired before the courts.

Impact Assessment

Q34: Do you agree with the impact assessment that accompanies this consultation paper? If not, please give reasons and evidence to support your conclusions.

We agree.

Equalities Statement

Q35: Do you think we have correctly identified the range and extent of effects of these proposals on those with protected characteristics under the Equality Act 2010?

Yes

Q36: If not, are you aware of any evidence that we have not considered as part of our equality analysis? Please supply the evidence. What is the effect of this evidence on our proposals?