| Title: Personal injury discount rate – how it should be set | **Regulatory Impact Assessment (RIA)** |
|---|---|
| | **Date:** April 2020 |
| | **Type of measure:** Primary Legislation |
| **Lead department or agency:** Department of Justice | **Stage:** Initial |
| | **Source of intervention:** Domestic NI |
| **Other departments or agencies:** n/a | **Contact details:** Martin Moore |
| | martin.moore@justice-ni.x.gsi.gov.uk |
| | 028 9016 3206 |

## Summary Intervention and Options

**What is the problem under consigderation? Why is government intervention necessary?** (7 lines maximum)
The personal injury discount rate is set by the Department of Justice and must currently be set, in accordance with the decision of the House of Lords in *Wells v Wells,* with reference solely to index-linked gilts (very low-risk investments). However, evidence suggests that, in reality, recipients of awards of damages invest their awards in low-risk investments which deliver greater returns than ILGs. This leads to higher costs for public bodies (higher compensation payments), businesses and consumers (increased insurance premiums). Primary legislation is required to change the legal framework for setting the rate.

**What are the policy objectives and the intended effects?** (7 lines maximum)
The policy objective is to provide for a legal framework for setting the personal injury discount rate that gives effect to the 100% rule (ie. leads to an award of damages which fully compensates the claimant but neither over nor under-compensates them) and so is fair to claimants, defendants and wider society.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)** (10 lines maximum)
The policy options under consideration are:

- do nothing (continue to set the rate under *Wells v Wells*); *or*
- change the legal framework under which the rate is set (in particular the assumptions about the level of investment risk), by adopting either:
    - the legal framework for England and Wales (based on a low-risk unspecified diversified portfolio), or
    - the legal framework for Scotland (based on a specified low-risk notional portfolio with two standard adjustments).

| | |
|---|---|
| **Will the policy be reviewed?** Yes | **If applicable, set review date:** The legal framework will be reviewed periodically. |

| Cost of Preferred (or more likely) Option | | |
|---|---|---|
| **Total outlay cost for business** £m | **Total net cost to business per year** £m | **Annual cost for implementation by Regulator** £m |
| Not quantified | Not quantified | n/a |

| | | | | |
|---|---|---|---|---|
| **Does Implementation go beyond minimum EU requirements?** | | | **YES** ☐ | **NO** ☐ |
| **Is this measure likely to impact on trade and investment?** | | | **YES** ☐ | **NO** ☒ |
| Are any of these organisations in scope? | **Micro** Yes ☒ No ☐ | **Small** Yes ☒ No ☐ | **Medium** Yes ☒ No ☐ | **Large** Yes ☒ No ☐ |

**The final RIA supporting legislation must be attached to the Explanatory Memorandum and published with it.**
Approved by: Jane Maguire Date: 12 May 2020

# Summary: Analysis and Evidence

The discount rate is applied by courts to awards of damages for future financial loss in personal injury cases to take account of an assumed rate of return on investment of the sum by the claimant, in line with the 100% rule. The higher the rate, the lower the cash value of the sum; and the lower the rate, the higher the cash value of the sum. The effect of the rate differs, depending on the size of the award and the period of time to which it relates: the larger the award and the longer the period of time, the greater effect the discount rate has. If awards increase in value, insurance premiums will rise to cover the additional cost of those awards.

It isn’t possible to quantify the costs and benefits of different frameworks for setting the personal injury discount rate in Northern Ireland because (i) there are no available records of the details of damages awards in the courts, or settlements reached out of court; (ii) it is not possible for the Department to quantify the impact of higher or lower damages awards on insurance premiums, and (iii) the actual rate set under any new framework is impossible to know as it will be set based on data available at that time. It is, however, possible to illustrate the impact of different rates using hypothetical scenarios (see below).

**Effect of different discount rates on an award covering annual care costs of £100,000 for the rest of the claimant’s life in two scenarios.**

| Discount rate | Total award | |
|---|---|---|
| | 40-year-old male with normal life expectancy | 10-year-old female with normal life expectancy |
| 2.5% | £2,652,000 | £3,475,000 |
| 1% | £3,611,000 | £5,557,000 |
| –0.25% | £4,876,000 | £9,128,000 |
| –0.75% | £5,566,000 | £11,470,000 |
| –2% | £8,005,000 | £21,931,000 |

It is also possible to identify non-monetised costs and benefits to affected groups. The effect of the policy will be to change the legal framework for setting the personal injury discount rate so that it is based on returns available on a range of low-risk investment products rather than solely on very-low-risk ILGs, with a view to providing 100% compensation. A rate set under the new framework will therefore be higher than a rate set under the existing framework at the same point in time.

Main affected groups can be identified as follows:

1. Claimants (persons who have been awarded damages in compensation for personal injury).
2. Direct defendants (persons or organisations who have caused a personal injury and who are liable to pay compensation directly to the claimant). These are usually public bodies like Government departments.
3. Consumers (persons who purchase insurance policies, e.g. motor insurance, to insure themselves against the cost of damages).
4. Businesses (individual businesses which purchase insurance policies, e.g. public liability insurance or motor insurance, to insure themselves against the cost of damages).
5. Insurance companies (providing insurance to groups 3 and 4).

The following table attempts to identify non-monetised costs and benefits to each group of a hypothetical discount rate set at the same time and under the same circumstances for Option 1 (with reference solely to ILGs) and for Option 2 (with reference to assumed low-risk investments, based on how claimants actually invest).

| *Group* | *Costs* | | *Benefits* | |
|---|---|---|---|---|
| | Option 1 (Do nothing) | Option 2 (Change the legal framework) | Option 1 (Do nothing) | Option 2 (Change the legal framework) |
| 1. Claimants | None. | No direct costs. Lower cash value of damages awards. | No direct benefits. Higher cash value of damages awards. | None. |
| 2. Direct defendants | Higher financial liability. | None. | None. | Lower financial liability. |
| 3. Consumers | Higher insurance premiums. | None. | None. | Lower insurance premiums. |
| 4. Businesses | Higher insurance premiums. | None. | None. | Lower insurance premiums. |
| 5. Insurance companies | Higher financial liability | None. | None. | Lower financial liability. |

**BUSINESS ASSESSMENT (Option** 1**)**

It isn't possible to quantify the impact on business, but as the table above shows, this option is likely to result in higher cost for businesses in the form of higher insurance premiums or higher financial liability.

**BUSINESS ASSESSMENT (Option** 2**)**

It isn't possible to quantify the impact on business, but as the table above shows, this option is likely to result in lower cost for businesses in the form of lower insurance premiums or lower financial liability.

**Cross Border Issues (Options** 1 and 2**)**

**How does this option compare to other UK regions and to other EU Member States (particularly Republic of Ireland)** Maximum 3 lines

The discount rate in the other two UK jurisdictions is already set with reference to low-risk investment products that take into account how claimants actually invest. The discount rate in the Republic of Ireland is set by the judiciary.

In 2017, the Government Actuary's Department (GAD) forecast what the outcomes would be for claimants under different illustrative discount rates, based on investments that reflect how awards are invested in reality (according to information provided by investment advisers and wealth managers in responses provided to the 2017 consultation exercise).[1] GAD simulated two different low-risk 30-year investment strategies under 1,000 different economic scenarios. Table 10 from GAD's report (reproduced below) illustrates the results for each of the illustrative discount rates and for each investment strategy (Portfolio A and Portfolio B). The green figures represent the percentage of over-compensation resulting from each discount rate for each investment strategy. It can be clearly seen that the higher the rate, the greater the amount of over-compensation.

*Table 10 – Percentile distribution of over/under-compensation*

| | Award basis | Percentile of over/under-compensation for a claimant with a 30 year award | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 5th | 10th | 15th | 20th | 25th | 30th | 35th | 40th | 45th | 50th | 55th | 60th | 65th | 70th | 75th | 80th | 85th | 90th | 95th |
| Portfolio A | RPI-1.75% | 16% | 25% | 31% | 36% | 41% | 45% | 49% | 53% | 56% | 59% | 63% | 68% | 72% | 75% | 80% | 86% | 93% | 104% | 118% |
| | RPI-0.75% | -1% | 6% | 12% | 15% | 20% | 23% | 27% | 30% | 32% | 35% | 39% | 43% | 46% | 49% | 53% | 58% | 64% | 74% | 86% |
| | RPI-0.5% | -5% | 2% | 7% | 11% | 15% | 19% | 22% | 25% | 27% | 30% | 34% | 37% | 40% | 43% | 47% | 52% | 58% | 67% | 79% |
| | RPI+0% | -12% | -5% | 0% | 3% | 7% | 10% | 13% | 16% | 18% | 21% | 24% | 27% | 30% | 33% | 37% | 41% | 46% | 55% | 66% |
| | RPI+0.5% | -18% | -12% | -7% | -4% | -1% | 2% | 5% | 8% | 10% | 12% | 15% | 18% | 21% | 23% | 27% | 31% | 36% | 44% | 54% |
| | RPI+1% | -24% | -18% | -14% | -11% | -8% | -5% | -2% | 0% | 2% | 4% | 7% | 10% | 12% | 15% | 18% | 22% | 26% | 34% | 43% |
| Portfolio B | RPI-1.75% | 6% | 17% | 28% | 35% | 44% | 50% | 57% | 64% | 69% | 75% | 83% | 92% | 99% | 106% | 116% | 129% | 141% | 157% | 183% |
| | RPI-0.75% | -9% | 0% | 9% | 15% | 23% | 28% | 34% | 39% | 44% | 49% | 56% | 64% | 69% | 75% | 84% | 95% | 105% | 119% | 141% |
| | RPI-0.5% | -13% | -4% | 5% | 11% | 18% | 23% | 29% | 34% | 38% | 44% | 50% | 57% | 63% | 69% | 77% | 87% | 97% | 110% | 132% |
| | RPI+0% | -19% | -11% | -3% | 3% | 9% | 14% | 19% | 24% | 28% | 33% | 39% | 46% | 51% | 56% | 64% | 73% | 83% | 95% | 115% |
| | RPI+0.5% | -25% | -17% | -10% | -5% | 1% | 6% | 11% | 15% | 19% | 24% | 29% | 36% | 40% | 45% | 52% | 61% | 70% | 81% | 99% |
| | RPI+1% | -30% | -23% | -16% | -11% | -6% | -2% | 3% | 7% | 11% | 15% | 20% | 26% | 30% | 35% | 42% | 50% | 58% | 68% | 86% |

[1] Government Actuary's Department (2017), *Ministry of Justice: Personal Injury Discount Rate Analysis.* Available at: https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/gad-analysis.pdf.