Institute and Faculty of Actuaries

17 April 2024

Ministry of Justice Call for Evidence

Setting the Personal Injury Discount Rate

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

The IFoA welcomes the opportunity to respond to the MoJ's Call for Evidence on setting the PIDR. It is important that the methodology for setting the discount rate is both fair to all and practical to implement.

As for any IFoA response, we have considered the Call for Evidence from an independent, public interest perspective.

We responded to the MoJ's previous Call for Evidence on the setting of the PIDR in 2019. In that response, we set out our view that the discount rate should be derived from a risk-free rate of return. Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate increases this risk.

It is also the IFoA's view that for some elements of compensation, claimants are best served by the use of a PPO given the closer match to their liabilities, and removing them from the investment and longevity risks associated with a lump sum compensation payment.

The 'underlying principle' for personal injury claims is that when damages are paid, they should as far as possible put the claimant in the same position as they would have been in if the accident had not happened - no more and no less. This principle means that assumptions used in the determination of the PIDR should be set at a central best estimate level with no prudence or optimism. Using inappropriately optimistic assumptions would risk under-compensation for claimants. Conversely, using a discount rate based on prudent assumptions could over-compensate claimants and be unfair for premium-paying policyholders (in relation to compensation paid by the insurance industry which would result in higher premiums) and taxpayers (in relation to compensation paid by the NHS).

A sex agnostic representative claimant life expectancy would result in fairer outcomes for claimants. However, the variety of claimant characteristics make the concept of a representative claimant imperfect for application in all cases. A system of PIDR (rates) better reflecting claimant specific life expectancies, such as a dual rate, could address this issue.

A comparison of care workers wage inflation to CPI suggests that an assumption based on 50% of loss escalating at CPI is too low. However, no single inflation rate is likely to capture a representative claimant. Therefore we expect a dual rate may be well placed (at least on a theoretical basis) to better reflect the inflation exposure faced by different claimants.

Evidence suggests a dual rate by duration has created a manageable level of complexity for claimants and compensators alike in the Canadian province of Ontario. However, we strongly suggest that adequate lead time is given to all stakeholders before any changes to the Ogden discount rate methodology is introduced.

A Heads of Loss approach could add significant complexity to the litigation process, contributing to delays in claims settlement and increased costs.

PPOs remain readily available and where they are not utilised, this is generally because of suitability or the willingness of one or other party, rather than a lack of availability. The primary influence on PPO take up versus lump sum are the preferences of claimants and insurers alike.

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Ministry of Justice (MoJ)'s Call for Evidence on setting the Personal Injury Discount Rate (PIDR). It is important that the methodology for setting the discount rate is both fair to all and practical to implement.

2. In developing our response to the Call for Evidence, we have drawn largely upon input from members of our Ogden Discount Rate Working Party. This working party is comprised of actuaries working across the general insurance industry, ranging from corporate firms and consultancies; it has been working on and estimating the impact of various different methodologies and assumptions on potential future PIDR rates. We have also had further input from members of our General Insurance Board and Standard and Consultations Committee.

3. It is important to note that, as for any IFoA response, we have considered the MoJ's Call for Evidence from an independent, public interest perspective. In doing so we have focussed on the underlying principle articulated in the Foreword to the Call for Evidence and our public interest duty.

4. We believe it is important to remember that the PIDR impacts individuals who in some cases have suffered life-changing injuries and need to be compensated for the cost of care for these injuries.

5. We believe that the IFoA has an important role to play in the debate on the future methodology of the personal injury discount rate. We would therefore be delighted to discuss our response with MoJ in due course.

6. The IFoA responded to the MoJ's previous Call for Evidence on the setting of the personal injury discount rate in 2019. In that response, we set out our view that the discount rate should be derived from a risk-free rate of return, consistent with the matching approach of the IFoA's discount rate framework (see A Framework for the use of Discount Rates in Actuarial Work). Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate increases this risk.

7. It is also the IFoA's view that for some elements of compensation, claimants are best served by the use of a PPO given the closer match to their liabilities and removing them from the investment and longevity risks associated with a lump sum compensation payment.

8. We acknowledge however that the Civil Liabilities Act 2018 sets out the legislative basis for determining the personal injury discount rate, including the use of a representative investment portfolio to inform the Lord Chancellor's decision. Our response to this Call for Evidence therefore reflects our views on the questions being consulted on, rather than revisiting earlier discussions on risk appetite/ risk-free rates of return.

Note: we have answered a subset of the Call for Evidence questions in the Appendix to this letter, but we would summarise our key themes as follows:

- the 'underlying principle' for personal injury claims is that when damages are paid, they should as far as possible put the claimant in the same position as they would have been in if the accident had not happened – no more and no less. This principle means that assumptions used in the determination of the PIDR should be set at a central best estimate level with no prudence or optimism. Using inappropriately optimistic assumptions would risk under-compensation for claimants. Conversely, using a discount rate based on prudent assumptions could over-compensate claimants and be unfair for premium-paying policyholders (in relation to compensation paid by the insurance industry which would result in higher premiums) and taxpayers (in relation to compensation paid by the NHS);
- the IFoA responded to the MoJ's previous Calls for Evidence on the setting of the PIDR in 2013 (2013 MoJ IFoA Response) and 2017 (2017 MoJ IFoA Response), including our view that the

discount rate should be derived from a risk-free rate of return, consistent with the matching approach of the IFoA's discount rate framework (IFoA Discount Rate Framework). We acknowledge however that the Civil Liabilities Act 2018 sets out the legislative basis for determining the PIDR, including the use of a representative investment portfolio to inform the Lord Chancellor's decision. Our response to the Call for Evidence therefore sets out views on a possible diversified portfolio which meets the requirements of the Act;

- a sex agnostic representative claimant life expectancy would result in fairer outcomes for claimants;
- the variety of claimant characteristics make the concept of a representative claimant imperfect for application in all cases. A system of PIDR (rates) better reflecting claimant specific life expectancies, such as a dual rate, could address this issue;
- a comparison of care workers wage inflation to CPI suggests that an assumption based on 50% of loss escalating at CPI is too low. However, no single inflation rate is likely to capture a representative claimant. Therefore we expect a dual rate may be well-placed (at least on a theoretical basis) to better reflect the inflation exposure faced by different claimants;
- evidence suggests a dual rate by duration has created a manageable level of complexity for claimants and compensators alike in the Canadian province of Ontario (although we are aware that the authorities in Ontario have been actively considering whether to return to a single rate). Of greater concern are the timelines for the implementation of such a system, with a short period between the announcement of a dual rate and its implementation posing a risk to the capacity to implement such a system effectively with consequences for claim life cycles. We strongly suggest that adequate lead time is given to all stakeholders before any changes to the Ogden discount rate methodology is introduced;
- a Heads of Loss approach could add significant complexity to the litigation process, contributing to delays in claims settlement and increased costs. Evidence suggests a Heads of Loss approach in the Republic of Ireland has not contributed to claimants investing differently to reflect their different costs and in practice, settlements are often made at an overall level;
- PPOs remain readily available and where PPOs are not utilised, this is generally because of suitability or the willingness of one or other party, rather than a lack of availability. The primary influence on PPO take up versus lump sum are the preferences of claimants and insurers alike. The flexibility and freedom of a lump sum, coupled with the current Ogden rate (value), make lump sums particularly attractive for claimants. Insurers continue to prefer lump sums to avoid the continuing uncertainty and long-term capital requirements associated with holding PPO liabilities on their balance sheets for several decades.

Should you want to discuss any of the points raised please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Mohammad Khan
Chair, Ogden Discount Rate Working Party

Steven Graham
Technical Policy Manager
On behalf of Institute and Faculty of Actuaries

Appendix: Responses to Questions within Call for Evidence

We have answered a subset of the Call for Evidence Questions, where we have specific qualitative or quantitative points to raise.

Question 1: Please provide evidence relating to the numbers of claims split by value and length of awards.

1. The IFoA Periodical Payment Orders Working Party (PPO WP) conducts an annual survey of the UK motor insurance industry about their experience of PPOs. This has enabled:

- creation and publication of statistics about the number, quantum, and nature of PPOs as awarded by the courts;
- qualitative feedback from the industry about their concerns and practices as regards to PPOs.

2. The focus of the PPO WP is on the creation of statistics for PPO awards. Historically such claims have been a significant proportion of the large motor personal injury claims as shown in the chart below. Large claims are defined as claims larger than £1m in 2011 terms, indexed at 7% per annum. The claim size thresholds are also defined in 2011 terms, indexed at 7% per annum.

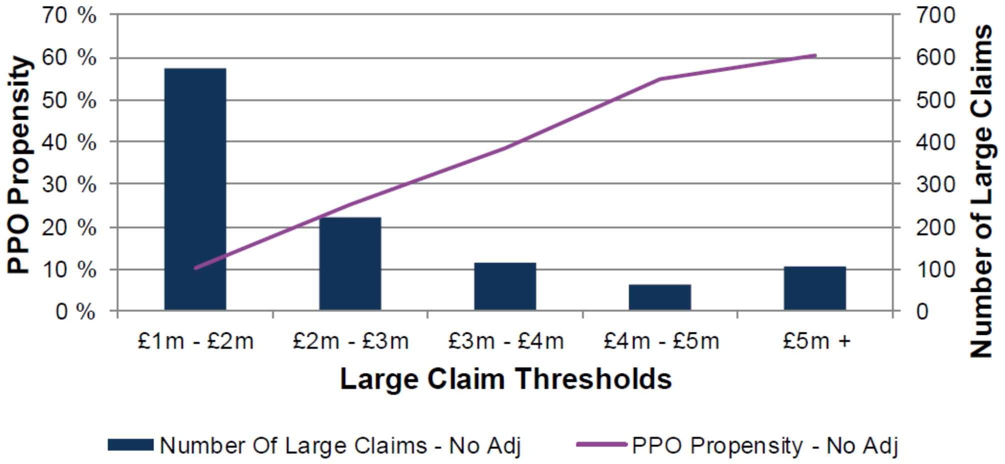

Figure 12: Motor (non-MIB) PPO propensity, by incremental large claim threshold band (2011 terms), for claims settled since 2009

Source: PPO WP Update - 2021 Industry Survey (15 September 2022)

3. The overall propensity for large claims to settle as a PPO has reduced from approximately 35% in the period 2009 to 2012, to approximately 10% in 2020. This means that many of the larger lump sum settlements in recent years are likely to have claimant characteristics similar to the PPO settlements in the PPO WP 2021 Industry Survey ('2021 Survey').

4. Although the statistics in the 2021 Survey are not a representative sample of all Motor large claims, we thought it would be helpful to share the following statistics relating the split by length of award. The chart below shows the distribution of the life expectancy of claimant at settlement date for PPO claims:

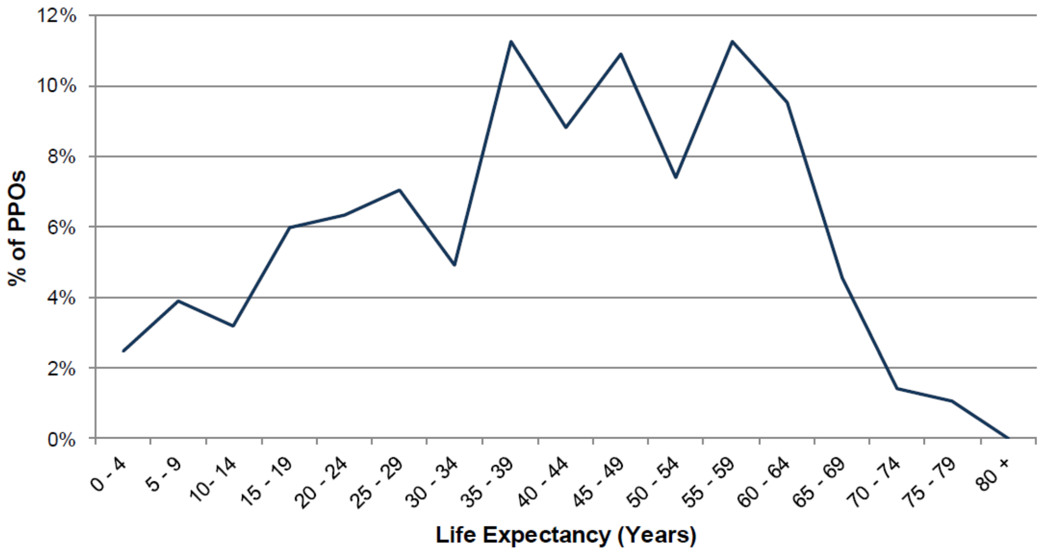

Figure 22: Distribution of the life expectancy of claimant at settlement date, for Motor (non-MIB) PPO claims, for claims settled since 2009

Source: PPO WP - 2021 Industry Survey (15 September 2022)

5. The chart below shows the distribution of the size for the lump sum element of Motor PPO claims and the size of Motor non-PPO claims. The amounts are in nominal terms i.e. at the time of settlement:

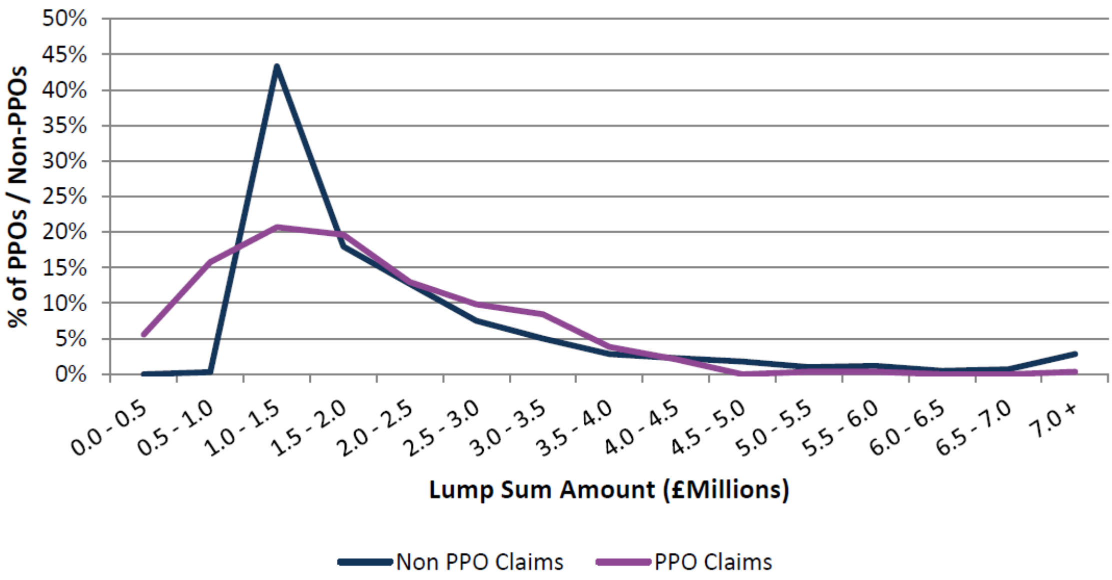

Figure N.7: Distribution of the size of the lump sum element of Motor (non-MIB) PPO claims and the size of Motor (non-MIB) non-PPO claims, for claims settled since 2009

Source: PPO WP - 2021 Industry Survey (15 September 2022)

The PPO WP 2021 Industry Survey can be found here:

https://www.actuaries.org.uk/practice-areas/general-insurance/research-working-parties/periodical-payment-orders-ppos

6. The IFoA Third Party Working Party (TPWP) investigates motor claims (injury and property damage). Their latest analysis was presented at the IFoA GIRO Conference in November 2023.

7. The table below shows the distribution by size of claim for Private Car Comprehensive insurance:

Private Car Comprehensive Excess TPI Type 2 Layered Results (all layers given in 2010 money, indexed at 7% pa)

Accident Year	£100k - 250k	£250k - 500k	£500k - 1m	£1m - 2m	£2m to 5m	> £5m
Frequency exc Nils (finishing in layer) (claims per million policy years)						
2013	54.2	15.1	6.9	4.2	2.3	2.3
2014	38.0	13.1	6.0	3.5	3.1	1.3
2015	35.4	11.8	5.5	2.5	2.5	1.3
2016	33.7	11.9	5.7	2.6	3.3	1.5
2017	28.7	10.4	6.8	4.0	2.7	1.2
2018	28.6	10.2	5.6	2.9	2.2	1.0
2019	29.3	9.6	4.6	3.0	2.0	1.2
2020	21.4	8.1	4.2	2.7	2.0	1.2
2021	21.1	8.2	4.3	2.0	2.0	1.0
2022	27.0	9.2	4.4	2.7	2.1	1.2
Average Cost (£000s)						
2013	187	415	839	1,709	3,920	11,450
2014	206	460	906	1,776	4,374	11,410
2015	217	486	999	1,990	4,542	11,659
2016	227	516	1,090	2,137	4,496	12,504
2017	250	562	1,087	2,203	4,942	13,684
2018	267	596	1,150	2,375	4,752	13,931
2019	280	629	1,303	2,509	5,176	12,638
2020	293	673	1,399	2,795	5,858	13,008
2021	322	746	1,491	2,670	6,009	14,745
2022	349	799	1,578	3,006	5,399	16,909
Burning Cost (£)						
2013	10.1	6.3	5.7	7.1	9.1	26.6
2014	7.8	6.0	5.4	6.2	13.4	14.6
2015	7.7	5.7	5.5	5.0	11.2	15.7
2016	7.6	6.1	6.2	5.6	15.0	18.4
2017	7.2	5.9	7.4	8.9	13.5	16.7
2018	7.7	6.0	6.5	6.8	10.6	14.1
2019	8.2	6.1	6.0	7.4	10.6	15.7
2020	6.3	5.5	5.8	7.4	11.9	15.0
2021	6.8	6.1	6.4	5.3	11.8	14.3
2022	9.4	7.4	6.9	8.2	11.3	20.1

Source: Update from the TP WP - GIRO50 Conference 2023 (1-3 November 2023)

8. For example, the frequency of claims which settle above an indexed £5m for accident year 2022 is estimated to be 1.2 per million policy years. The average cost of such claim is estimated to be £16.9m. The claim amounts include all heads of damage.

The latest Third Party Working Party analysis can be found here:

https://www.actuaries.org.uk/practice-areas/general-insurance/research-working-parties/third-party

Question 3: Based on the evidence supplied in 2018/2019, the Government Actuary's advice to the Lord Chancellor assumed the representative claimant invested over a period of 43 years. Does 43 years remain a suitable assumption (please explain the rationale and evidence for your response)?

9. We do not have any detailed data showing the terms over which claims are awarded, however, our Ogden Working Party did conduct a survey of financial advisers specialising in the personal injury space during 2021. The advisers confirmed that they used the expected future lifetime of their clients for their investment horizon. The advisers noted that investment horizons vary significantly across their clients (i.e. the claimants) as some are young (e.g. 10-year olds), and others in their 70s and therefore because asset mixes reflect this large variation in time horizon, it is difficult to prescribe a single 'average' time horizon or investment portfolio.

10. We would note that the evidence supplied in 2018/19 assumed that the claimant was a male living for the next 43 years. We would suggest that the representative claimant life expectancy chosen should be based on data and analysis that is sex agnostic.

Question 4: Are there any cohorts of ‘alternative representative claimants’ that you believe have characteristics which are materially different from the representative claimant defined above, and who should therefore be considered separately when modelling claimant outcomes?

Please define the characteristics of these cohort(s).

11. As noted above, using averages to reflect a representative claimant is potentially dangerous given the significant variation in investment time horizons across the different types of claimants (based mainly on their age), and also given that the financial advice process starts with a claimant's attitude to risk and capacity for loss which will vary significantly across different individuals - be they personal injury claimants or not. A verbatim quote from our financial adviser survey is as follows:

    ‘No two clients are the same and therefore the investment horizon varies considerably from client to client.’

12. However, we recognise that whilst using averages is not perfect, it is a practical approach and that given the significant mix of claimants (sex/ age/ impairment etc), that a more refined approach could become overly complex and burdensome to compute and communicate.

13. Using a dual or multiple rate methodology may lead to a fairer outcome for claimants in this regard, better reflecting an individual’s specific life expectancy and resulting investment time horizon.

Question 8: Is the 2019 position that the representative claimant’s damages are inflated at a rate of CPI+1% (as shown in paragraph 28 above) on average still a suitable assumption and if not, how would you change it (please provide evidence/reasoning for your response)?

14. We do not have detailed data for claims showing the split in value for each Heads of Loss, however, we would point out that each claimant will suffer their own *personal inflation level* depending on the heads of loss of their claim.

15. For example, for more catastrophic claims, because the individual is less likely to be able to work, the component for loss of future earnings tends to represent a higher proportion of annual costs than for less catastrophic cases. Equally, those who were high earners also have an over-weight in their overall claims make-up to earnings-related loss components than those who were on lower salaries. Equally, those with more severe injuries requiring full-time care by one or more carers, will have a higher component of earnings-related (e.g. carers' salaries) than those who are cared for by family or are less severely injured requiring less external care.

16. A comparison of ASHE 6115 (care workers' wage index) and CPI, shows that ASHE 6115 has been in excess of CPI for extended periods of time since it was introduced which might lead to the conclusion that an assumption based on 50% of loss escalating at CPI could be too low.

17. Given the above, we would suggest that a dual rate or multiple rate may be better able to match the inflation rates that claimants suffer - especially between ‘simpler’ and ‘catastrophic’ claims.

Question 9: What asset classes should be included in a 'low risk' portfolio, and are there any asset classes that are not generally available and/or suitable for personal injury claimants (please provide reasoning and/or evidence in support of your views)?

18. The 'underlying principle' for personal injury claims is that when damages are paid, they should as far as possible put the claimant in the same position as they would have been in if the accident had not happened – no more and no less. This principle means that assumptions used in the determination of the PIDR should be set at a central best estimate level with no prudence or optimism. Using inappropriately optimistic assumptions would risk under-compensation for claimants. Conversely, using a discount rate based on prudent assumptions could over-compensate claimants and be unfair for premium-paying policyholders (in relation to compensation paid by the insurance industry) and taxpayers (in relation to compensation paid by the NHS).

19. The IFoA responded to the MoJ's previous Calls for Evidence on the setting of the PIDR in 2013 (2013 MoJ IFoA Response) and 2017 (2017 MoJ IFoA Response), including our view that the discount rate should be derived from a risk-free rate of return, consistent with the matching approach of the IFoA's discount rate framework (IFoA Discount Rate Framework).

20. Using a discount rate based on the expected return from a low risk portfolio would necessitate a change to the underlying principle to require only that the claimant has a high likelihood of being put in the same position. In this respect the underlying principle is incompatible with the Civil Liability Act 2018. Nevertheless, we acknowledge that Parliament has chosen to take this step in passing the Civil Liability Act, and we answer the remainder of this question within that legislative framework.

21. In our response we will define a 'low risk' portfolio as a set of investments that maximise investment returns subject to being 90% confident that these will exceed CPI + 1% annual investment return threshold, measured over a 20-year period or longer. Furthermore, in our response we are including an additional efficiency constraint. This requires the portfolio to achieve the investment goal with higher probability of fulfilment, than others. However, it also implies that there is only a 90% likelihood that the underlying principle will be achieved.

22. Consistent with that definition, in the current economic environment and considering the expectations about the future, we suggest that the following asset classes are considered in the asset allocation:

    i. Global investment grade credit, with annualised volatility between 2% and 7%;
    ii. Global high yield credit, with annualised volatility between 5% and 10%;
    iii. Emerging market sovereign and quasi-sovereign debt, with annualised volatility between 5% and 10%;
    iv. Global publicly traded equities, with annualised volatility between 12% and 25%;
    v. Infrastructure equity and debt funds, with annualised volatility between 10% and 20%; and
    vi. Global real estate equity and debt funds, with annualised volatility between 10% and 30%.

23. We would also suggest avoiding the use of unclearly defined concepts such as 'alternatives' assets, as this can lead to very dissimilar risks, ranging from near 2% to over 100% annualised volatility. Furthermore, we would highlight that the term 'alternatives', albeit extensively used, has a strong commercial influence and little investment or actuarial significance, which may undermine the credibility of this exercise.

24. Other important reasons why we would suggest avoiding the wide range of asset classes generally comprised under the commercial label 'alternatives' are:

    - they are not realistically comprehensible by individuals with a low degree of investment sophistication, such as most claimants;

- they are often idiosyncratic investments highly dependent on the performance of the investment manager, which selecting requires a degree of experience that substantially exceeds what a claimant or a financial advisor can reasonably do;
- many investment vehicles that fall under Alternative Investment Fund laws (using that as a proxy for 'alternatives') are legally inaccessible to individuals or non-qualified investors.

Question 11: Do you believe the investment strategy that was assumed to be adopted by the representative claimant in the 2019 Government Actuary's analysis (as described in paragraphs 33 to 36 and Table 1 above), remains appropriate? If not, how would you change it for a current view of the representative claimant or alternative representative claimants?

25. As noted in the main body of this response, the IFoA responded to the MoJ's previous Call for Evidence on the setting of the personal injury discount rate in 2019. In that response, we set out our view that the discount rate should be derived from a risk-free rate of return consistent with the matching approach of the IFoA's discount rate framework (see A Framework for the use of Discount Rates in Actuarial Work).

26. Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate, such as one based on the expected return from a low risk (rather than very low risk) portfolio increases this risk. Nevertheless, we acknowledge that Parliament has chosen to take this step in passing the Civil Liability Act 2018, and we answer the remainder of this question within that legislative framework.

27. From our assessment and experience, the investment strategy proposed in 2019 was and remains, sub-optimal to achieve the investment goal, for multiple reasons.

28. The decomposition between matching and non-matching assets, which is reasonable in the context of a DB fund that pools multiple risks and benefits from support from the corporate sponsor, is imprudent in the context of the management of capital that is intended to support a single individual over an uncertain period. We would suggest avoiding such an approach and to focus on composing investment portfolios that fulfil the actual investment goal efficiently, as described in our response to question 9.

29. The allocation to cash appears excessive under any risks or cash flow management considerations, which may increase the risk in the asset allocation.

30. The large allocation to UK government securities increases the risk in the asset allocation, as these typically generate extreme volatility and their contribution to achieving the investment goal would be, in the current environment and in most others, negative.

Question 12: To what extent has the way claimants are advised to, and actually, invest been affected by recent changes in economic conditions (e.g., high interest and inflation rates)?

31. Real interest rates in the UK remain suppressed, however they have moved upwards closer to zero and in some instances slightly above. This is favourable for investors that aim to achieve an inflation-linked investment goal such as that of claimants.

32. The IFoA has no evidence on the advice given to claimants or their actual investment decisions.

Question 22: How much additional complexity or difficulty would implementing a dual rate by duration approach add to the litigation process (please provide evidence to quantify this either by time to settlement, additional legal costs and/or any other relevant factors)?

33. A single rate system brings with it the advantages of simplicity and consistency. This significantly aids the understanding of non-financially technical stakeholders including legal professionals and claimants/ their representatives. The approach is proven and the GAD methodology is technically sound.

34. A dual rate system on the other hand is more complex and is therefore likely to be more difficult for stakeholders to understand. This will contribute to longer settlement negotiations and extended claim life cycles - especially in the year following implementation. This would likely lead to delays in claimants receiving compensation, at least in the short term, and additional legal costs being incurred which will adversely impact the premium-paying consumer and the taxpayer. I may however reduce the need for a margin for prudence.

35. The lack of a meaningful notice period for announcement and implementation of a dual or multiple rate system will necessarily lead to delays in the claims process. The development, testing and approval of updated claims calculators will take for use by insurers and claimant lawyers will take significant time.

36. We understand that many insurers have a preference for a single rate. However, should a dual rate be preferred, we have a preference for the 'switched dual rate' model (as used in Ontario, Canada). This blends current economic conditions, captured within a short-term rate, with the longer-term view, captured in a long-term rate.

37. Experience from those currently working in Ontario under this dual rate regime have indicated that the switched dual rate model, whilst adding complexity for both claimants and compensators, has been manageable (although we are aware that the authorities in Ontario have been actively considering whether to return to a single rate). It has had a limited contribution to technical disagreement between parties. We understand that global settlements are agreed without recourse to the dual rate regime in the vast majority of claims in Ontario, and that may explain why discount rate is not contentious. We do appreciate that the UK is an entirely different jurisdiction.

38. Ontario's long-term rate has been stable for over 20 years, but the short-term rate has changed almost annually. Any model change should ideally seek to promote stability and avoid the Discount Rate becoming contentious which could lead to increased expert report costs and prolonged claim lifecycles.

39. Of greater concern are the timelines for the implementation of such a dual rate system. If there is a short period between the announcement of a dual rate and its implementation, this could pose a risk to the capacity to implement such a system effectively with consequences for claim life cycles. We strongly suggest that adequate lead time is given to all stakeholders before any changes to the Ogden discount rate methodology is introduced.

Question 23: Should a dual rate mechanism be implemented, different asset returns would be assumed for the short and long-term. Under this mechanism, what changes to the following characteristics of the representative claimant (or alternative representative claimants) would apply:

a) Investment period;
b) Damage inflation;
c) Investment portfolio; and
d) Tax and Expenses assumptions.

40. A dual rate would distinguish between the risks and opportunities faced by claimants in the short term and long term which are considerably different and therefore allow a fairer outcome compared to a single rate.

41. As a general overall point, in the short-term claimants would be exposed to less risks and therefore a lower return assumption would be 'fairer'. And vice versa in the longer term.

42. In relation to the investment period, as with the current Ogden rate the life expectancy of the claimant would determine the investment period. Depending on the approach selected, for example, if a switch over point is introduced where an assumed investment period after a point uses one single higher rate and before that uses a lower rate we could see claimants position their case to obtain an assumed lower rate. This could potentially impact the assumed investment period.

43. With respect to damage inflation, in the longer term the claimant would be exposed to a high level of damages inflation relative to the shorter term.

44. In relation to investment portfolio, in the longer term the claimant would be in a position to optimise their portfolio and any short-term shocks could be withstood. Under a shorter time horizon these shocks would have a material impact on the portfolio of the claimant.

45. A higher level of taxation and expenses would be appropriate in the longer term, given the potential for higher returns.

Question 24: Should a discount rate by heads of loss be implemented, different damage inflation assumptions would be assumed for different heads of loss. Under this mechanism, what changes to the following characteristics of the representative claimant (or alternative representative claimants) would apply:

a) Investment period (under the single rate methodology, 43 years was previously assumed);
b) Investment portfolio (under the single rate methodology, a 57.5% allocation to matching assets and 42.5% allocation to growth assets was previously assumed. Please refer to Table 1 for full details); and
c) Tax and Expenses assumptions (under the single rate methodology, a range of 0%-0.5% based on the initial award value for the former and 0.6%-1.2% for the latter, with a total modelled assumption of 0.75% was previously assumed).

46. The IFoA responded to the MoJ's previous Calls for Evidence on the setting of the PIDR in 2013 (2013 MoJ IFoA Response) and 2017 (2017 MoJ IFoA Response), including our view that the discount rate should be derived from a risk-free rate of return, consistent with the matching approach of the IFoA's discount rate framework (IFoA Discount Rate Framework).

47. Using a discount rate based on the expected return from a low risk (rather than very low risk) portfolio would necessitate a change to the underlying principle to require only that the claimant has a high

likelihood of being put in the same position. Nevertheless, we acknowledge that Parliament has chosen to take this step in passing the Civil Liability Act 2018, and we answer the remainder of this question within that legislative framework.

48. The response to each part of the question is dependent on the Heads of Loss (HoLs) used. The most obvious split between heads of loss is between loss of future earnings and future care costs, and this has been used to illustrate the answers to each part of the question. In each case, our view is that the potential changes highlighted are less material than the possible difference in damage inflation assumptions between different heads of loss.

49. a) For each of the HoLs, the average future duration of the expected HoL would need to be considered. For example, if future loss of earnings and future care costs were separated then it could be the case that, owing to the proximity of the representative candidate to the age of retirement, the investment period for future loss of earnings is shorter than the investment period of future care costs if these will be required to end of life. In such a case the investment periods would be differ accordingly.

50. Typically, future care costs might be expected to be the longest duration element of an award, lasting for the whole of a claimant's life, and so the overall average investment period of 43 years would be suitable for this head of damage. The IFoA has no data on which to base estimates of the shorter average investment period for losses until the expected retirement date, but indicatively we might expect this average to be around 30-35 years; shorter than the overall average but still sufficient to be considered a long- term investment.

51. b) In a similar vein, the average portfolio of the representative claimant will be strongly linked to the investment period with respect to the split of matched assets and growth assets with the likelihood being that the longer the investment period the higher the allocation of portfolio to growth assets. If the HoL splits are not of materially different durations then it is likely that the investment portfolio will be the same for all HoLs.

52. It is worth noting that the asset allocation is likely to be affected by the cashflow-weighted average duration of the future losses being compensated, rather than the overall investment period which is defined as the time until the latest such cashflow. Thus if there were to be a split between future earnings and future care costs, the cashflow-weighted average duration of future care costs would be slightly longer than the overall average, even though we have argued in a) that the investment period is likely to be similar. Both future earnings and future care costs are likely to be considered long-term liabilities and therefore the differences in a representative investment portfolio between these heads are likely to be relatively small.

53. Indicatively, if the overall central portfolio has a 57.5:42.5 split between matching assets and growth assets, then it might be reasonable to expect a slightly heavier weighting to growth assets (perhaps 55:45) in the case of future care costs and a slightly lower weighting (perhaps 65:35) in the cost of future earnings.

54. c) The impact of tax on investment returns is already heavily dependent on an individual claimant's tax situation independent of an award for personal injury so it is unlikely that changes would be required to the tax assumptions. Expenses are more correlated with the investment strategy itself but given the representative portfolio will likely have a significant proportion of matched assets (with low active management required) and passively managed growth assets, expense assumptions are also unlikely to change exclusively for a move to HoL splits.

55. It could be argued that losses for future care costs, with a longer investment period and a higher proportion of growth assets, could be subject to a slightly higher expense charge; conversely it may be that the tax treatment for these assets may differ with a higher proportion of return deriving from capital gains rather than income. In our view any differences in the overall allowance for tax and expenses to vary between heads of loss is likely to be small and potentially spurious in comparison to the wide range of individual circumstances that would affect the costs for individual claimants.

Question 25: How much additional complexity or difficulty would this approach add to the litigation process, and would this be greater/ lesser/about the same as if a dual rate by duration were implemented? Please provide evidence to quantify this either by time to settlement, additional legal costs and/or any other relevant factors.

56. It is likely that a Heads of Loss approach would add significant complexity and cost leading to delays in making claims. Such an approach could create additional legal costs as well as contribute to 'satellite litigation' in allocating damages per head of loss. A new heads of loss approach is likely to incur significant administrative IT costs for compensators. This additional dispute would likely lead to delays in the claimant receiving their compensation, as well as driving unnecessary legal costs into the compensation system.

57. A Heads of Loss approach is adopted in the Republic of Ireland, but different legislation and levels of compensation apply compared to England & Wales. We understand that the costs of care packages are substantially smaller in Ireland, so it is difficult to draw inferences from Ireland due to the jurisdictional differences.

58. Experience from the Republic of Ireland has indicated that in practice, there is little evidence of claimants investing compensation in different 'pots' to fund future costs by varying Heads of Loss. In practice, settlements are often made at an overall level, that is, without allocating specifically between future care costs and other pecuniary losses. This avoids disagreements over the suitable rate applicable to different Heads of Loss. However, we note that experience in Ireland may not be replicated in England & Wales owing to the greater volume and complexity of larger claims which could create satellite litigation and substantial delays.

59. In England & Wales, the Civil Liability Act 2018 requires the Lord Chancellor to have regard to the actual investments made by investors of relevant damages, in making the rate determination. A different Heads of Loss approach would not reflect real-world investment practice as claimants do not typically invest different aspects of their damages differently.

60. We note further that PPOs already provide a mechanism for claimants to split out future care costs by Heads of Loss.

Question 26: Should a discount rate by heads of loss be implemented, do you believe that the concept of modelling one representative claimant remains appropriate or is modelling a representative claimant for each head of loss a better approach?

61. We believe the concept of modelling one representative claimant would still remain appropriate. Modelling one representative claimant has the advantage of being operationally easier:

- this is a more realistic approach as one claimant will be compensated for all Heads of Loss at any one time;
- both approaches are still taking an average as each individual case is unique and there are many possible variations recognising individual claimants' circumstances. Modelling for each Head of damage would not only overcomplicate matters, but could lead to an outcome that when combining the different models, the end result would not be representative of the class overall.

Question 29: How readily available are PPOs to claimants in practice and how does this vary by groups of claimants (additional data on groups that are less likely to have a PPO made readily available would be helpful)?

62. PPOs are typically available and are usually considered in cases where there are substantial recurring future costs, particularly relating to care needs. Where PPOs are not utilised, this is generally because of suitability or the willingness of one or other party, rather than a lack of availability. The main case in which PPOs are not available is where there is a cap on the amount of compensation available, for example through an insurance policy limit. This does not apply in the case of road traffic accident victims because compulsory motor insurance provides unlimited liability cover; this can occasionally be an issue however, where employers' or public liability insurance is involved.

Question 30: What factors influence the take up of lump sums versus PPOs? This could include the preferences and behaviours of one or more of the parties involved in the settlement process and associated litigation strategies.

63. PPOs are typically considered as a possible settlement route for large motor injury claims where there are substantial recurring future costs such as for care needs. The form of settlement often forms part of discussions between the injured party or their representatives and the compensator.

64. In many cases, injured parties or their representatives prefer lump sum settlements and either do not push for PPO settlement or simply use it as a negotiating tactic to seek a more attractive lump sum offer. There are a number of reasons why injured parties might prefer a lump sum settlement.

65. The wishes of the claimant's family are also often a factor, particularly where the injured party themselves may lack financial capacity. Reasons why an injured party might prefer a lump sum settlement include:

- seeking a clean break from the compensator to achieve some finality;
- to provide more flexibility to spend or invest money in a way that is not uniform across each year, for example if they have a desire to make short-term purchases above what is allowed for in a lump sum part of the compensation award;
- to ensure some money is left in the injured party's estate for the benefit of relatives in the event of the claimant's early death.

66. It is true that many insurers prefer to settle on a lump sum basis if possible, to avoid the continuing uncertainty and long-term capital requirements associated with holding PPO liabilities on their balance sheets for several decades. However, insurers are fully aware that Courts will award a PPO where the claimant wishes to settle on that basis and are happy to settle by way of PPO on appropriate cases. Conversely, other compensators may be less concerned about long-term balance sheet implications and may prefer the lower short-term cashflow requirements associated with a PPO settlement.

67. A majority of cases are settled by negotiation between the parties, with only a minority being settled by a Court, either in a contested trial or more commonly by Court approval of a negotiated settlement where the injured party lacks capacity. Where Court approval is required, there is typically a need to demonstrate at least that a PPO settlement has been considered, and this in itself can make a PPO more likely.

68. Other factors that can influence the take-up of PPOs versus lump sums include:

- contributory negligence. If the award will only meet a portion of the injured party's future care needs because of an element of contributory negligence, a PPO is typically less suitable because the annual payment by itself would be insufficient to meet the claimant's costs;
- uncertainty over life expectancy. Where there is greater uncertainty over an injured party's future life expectancy (for example where medical experts differ on the degree of life impairment) a PPO settlement is often more attractive because of the difficulty of calculating and agreeing an appropriate lump sum award;
- age of the injured party. Where the injured party is a minor and the award is for a very long period, PPO settlement is more common. This may also be influenced by the need for settlements involving minors to receive Court approval. Where the injured party is old there may also be a preference for a PPO, as the impact of living a short period of time more is greater where the future life expectancy is low.

Question 31: Please provide any evidence of how the setting of the discount rate may affect persons with protected characteristics.

69. With respect to age: the setting of the discount rate is a key driver of the cost of very large liability claims for insurers. Such costs are passed to policyholders through premiums and may be most likely to impact the premiums of younger drivers:

- coupled with the rise in personal motor premiums driven by high UK inflation, a lower discount rate has the potential to add further upwards pressure to premiums;
- younger drivers may be disproportionately impacted by claims inflation and this impact may be compounded;
- younger individuals of lower socioeconomic status living in rural areas are also likely to be disproportionately impacted. These individuals are more likely to place reliance on their car for access to work opportunities and further education.

70. With respect to disability, a high proportion of claimants will be classified as disabled and therefore achieving a fair level of compensation is important for their needs. Those with the most severe disabilities will require greater levels of care and the more expensive forms. Those with the greatest disabilities will therefore have more sensitivity to changes to the discount rate.

71. Some further relevant comments are:

- increased complexity in calculating the discount rate could lead to some groups being disadvantaged if they are not able to access professional advice. However, legal advice should be available and complexity exists in the current system too;
- the current claimant characteristics, based on a male with a 43 year life expectancy, fails to reflect adequately the population of personal injury claimants who are not exclusively male. A future life expectancy also reflecting female experience, or ideally agnostic in relation to gender, may mitigate this impact.