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Damages (Return on Investment) Bill

NIAR 127-21

This paper has been prepared to inform consideration of the Damages (Return on Investment) Bill.
The Bill has 6 clauses and a schedule. It aims to provide a new statutory methodology for calculating the personal injury discount rate for lump sum awards in personal injury cases and establishes a timeframe for review of the rate. It also provides that the task of reviewing and setting the rate will fall to the Government Actuary instead of the Department of Justice. This paper should be read in conjunction with paper NIAR 125-21.

The briefing should not be relied upon as legal or professional advice (or as a substitute for these) and a suitably qualified professional should be consulted if specific advice or information is required.

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Glossary

Damages - the legal term for compensation awarded by a court.

Defendant - the party defending the court action.

Gilts - the informal name for UK Government bonds. When the UK Government sells bonds, it agrees to pay a set return every six months until maturity. On maturity, the initial investment is also repaid. Index-linked gilts link both the bi-annual return and the repayment to inflation (via the Retail Price Index). Index-linked gilts have traditionally been considered a very safe form of investment to provide a future income stream.

Multiplier - the figure by which annual loss (the multiplicand) is multiplied by to calculate an award for future economic loss. It takes into account life expectancy, the period the award covers and the discount rate. The multiplier can be found using the Ogden Tables.

Ogden Tables - these are statistical tables used to calculate an appropriate lump sum in personal injury cases. They provide various 'multipliers' which can be used to turn an annual loss into an appropriate future award.

1 Introduction

The Personal Injury Discount Rate (PIDR) is a percentage rate used by the courts to adjust lump sum compensation awards to claimants of life changing injuries for future losses, costs and expenses. It is intended to ensure that a claimant neither benefits nor losses as a result of receiving the compensation before the loss has actually occurred. The overall aim, as stated by the House of Lords in the leading case of *Wells v Wells*, is that the award should fully compensate the claimant but no more or no less which is known as ‘the 100% rule’.

That judgement also decided that claimants should be treated as very risk averse investors, as they are often financially dependent on the lump sum for the duration of their lives. Therefore, they should be assumed to invest 100% in index-linked gilts (ILGs) in protecting an award of damages against inflation and against market risk.

In 2001, the Lord Chancellor set the discount rate at 2.5% for England and Wales and Northern Ireland under section 1 of the Damages Act 1996. The 1996 Act does not specify what the discount rate should be set so it is set in accordance with the legal principles established in *Wells v Wells*. Scottish Ministers did the same for Scotland in 2002, resulting in a uniform rate across the UK. The power to set the rate in Northern Ireland was devolved to the Department of Justice in 2010.

In 2012, there was a shared UK-wide consultation on reviewing the rate in each jurisdiction under the *Wells v Wells* framework. This was followed by the joint commissioning of a report by an expert panel to advise on how the rate should be set under that framework, but the panel did not reach any clear agreement. In 2013, all three legislatures published a joint consultation on reviewing the legal framework for setting the rate, but diverging views were expressed and again no consensus emerged.

In 2017, the rates in England and Wales and Scotland were reduced to minus 0.75% under the *Wells v Wells* principles. This large drop was reflective of the change in market conditions from 2001, which assumed a much lower rate of return on ILGs. Also in 2017, there was a further joint consultation by the Ministry of Justice and the Scottish Government on how the rate should be set in future. The Department of Justice, in the continuing absence of a functioning Assembly, did not participate. Following this, both England and Wales and Scotland decided to move away from the *Wells v Wells* principles and adopted new statutory frameworks to calculate the PIDR in 2018, and 2019, respectively.

Since then, the rate in Northern Ireland has been at a considerable divergence from the rates in the other UK jurisdictions. Following the appointment of a new Minister of Justice in January 2020, the Department of Justice gave further consideration to reviewing the discount rate in Northern Ireland under the *Wells v Wells* framework. The outcome of this was a proposed rate of minus 1.75%. Up until the end of May 2021, the rate in Northern Ireland remained at 2.5% which represented a rate of return over and above inflation. The subsequent change to minus 1.75% represented a significant 4.25% reduction in real terms. Northern Ireland now has the lowest discount rate in the UK.

The Damages (Return on Investment) Bill intends to amend the Damages Act 1996 as it applies to Northern Ireland, to create a new legislative framework for setting the discount rate and timeframe for review of the rate. It does not specify what the rate should be but intends for it to be set by the UK Government Actuary. The rate will be based on a specified notional portfolio of low-risk investments over a period of 43 years, allowing for inflation and applying two standard adjustments: a deduction of 0.75% to take into account the impact of taxation and the costs of investment advice and management; and a deduction of 0.5% as a further margin to mitigate against the risk of under-compensation.

The methodology has been based on the Scottish framework, with a variance in relation to the length of the assumed investment period. The Scottish framework utilises a period of 30 years, whereas the Department of Justice has acknowledged that an assumed investment period of 30 years may not correlate with the average or typical investment period for a lump-sum damages award. The assumed investment period in England and Wales of 43 years is considered to be a more appropriate time period by the Department.

The Bill also provides for 5-yearly reviews of the PIDR. The first review, which will begin as soon as the legislation is commenced, will be a review of the present rate which currently stands at minus 1.75%. The next review after that will be in July 2024, to align with the cycle of PIDR reviews in Scotland. Thereafter, a review of the rate will take place every five years. The aim of regular reviews of the PIDR, is to ensure that the rate is aligned with changing financial conditions.

The detail of the notional portfolio, the assumed period of investment and the amount of the standard adjustments can be changed by the Department by regulations subject to the draft affirmative procedure.

The paper is divided into the following sections:

- Section 1 is a brief introduction;
- Section 2 provides background and context to the Bill;
- Section 3 summarises UK wide developments to date;
- Section 4 provides an overview of the comparable arrangements in the other UK jurisdictions;
- Section 5 provides and overview of the current rate in Northern Ireland; and
- Section 6 provides Bill and clause commentary.

2 Background and Context

In a personal injury claim, an award of damages is made by the court in order to compensate a claimant who has suffered loss or damage as a result of a wrong which was not their fault. The principle underlying compensation is ‘restitutio in integrum’ which means putting claimants back in the position they would have been, were it not for the accident. It is a well-established legal principle that individuals should receive full compensation, but no more or no less. This is known as the 100% rule which was asserted by the House of Lords in the leading case of *Wells v Wells* which was set out by Lord Hope of Craighead (page 390A-B) as:

> *[...] to place the injured party as nearly as possible in the same financial position he or she would have been in but for the accident. The aim is to award such a sum of money as will amount to no more, and at the same time no less, than the net loss […].*[1]

The PIDR is used to determine lump sum awards of damages to claimants who have suffered a serious life changing personal injury. The PIDR is applied once the Court has assessed the claimant’s financial losses arising from the injury, mainly those relating to loss in future income and any medical care expenses. The Court applies the rate, with the assistance of what are known as the Ogden Tables, to adjust that lump sum to take account of the return that may be earned from investing it. This is done in accordance with the principle that claimants should be fully compensated, but no more or no less.

If a discount rate was not applied to a lump sum, paid at the time of the claim, then no account would be taken of the effect of the accelerated receipt of the monies due on the adequacy of the compensation. As such, a claimant could invest the money until it is needed and earn a considerable profit and become over-compensated. Similarly, if a claimant did not invest the money, it would leave the award subject to inflation and the risk of under compensation.

Not all personal injury claims will involve the application of the discount rate. It is only relevant in cases where there are future losses arising from the injuries sustained such as future salary losses and/or future care and medical costs. These cases tend to involve more serious injuries where there is little prospect of the claimant recovering to the extent of returning fully to work and/or requiring some care support for the duration of their lives.

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. Although the discount rate may be a relatively small percentage figure, when applied to the total cost of care in cases that cover long periods, it can mean very significant differences in the amount of the award as indicated in the table below.

[1] Wells v Wells [1999] 1 AC 345

Table 1: 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.[2]

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

Wells v Wells also specified that claimants should be treated as very risk averse investors, as they may be financially dependent on the lump sum awarded for the duration of their lives. It led to the conclusion that the PIDR should be based on an investment portfolio that offered the least risk to claimant investors in protecting an award against inflation and against market volatility and risk. A portfolio that contains 100% Index-Linked Gilts (ILGS)[3] was assumed to best meet that criterion at the time that the judgement was given.They are government bonds that protect against inflation, but, because they are so low-risk they deliver poor returns.

The PIDR mainly applies to personal injury claims that arise from medical negligence, industrial accidents and road traffic accidents. Often defendants in these cases will have some form of insurance cover. In most cases of clinical negligence, damages costs will fall on the Health and Social Care Northern Ireland (HSCNI) and medical defence organisations and, ultimately, the taxpayer. Currently in Northern Ireland the specific number of such cases is unknown:

> *NICTS statistics record 14,000 writs issued between 2010 and 2020; of which approximately 30% are claims arising from medical negligence or road traffic accidents. Many of the other cases, however, are also likely to involve personal injury*

[2] Department of Justice (2020) *The personal injury discount rate: How should it be set?* Pg 8 https://www.justice-ni.gov.uk/sites/default/files/consultations/justice/Personal%20Injury%20Discount%20Rate%20-%20How%20Should%20It%20Be%20Set%20a%20Consultation.pdf

[3] When the UK Government sells bonds, it agrees to pay a set return every six months until maturity. On maturity, the initial investment is also repaid. Index-linked gilts link both the bi-annual return and the repayment to inflation (via the Retail Price Index). Index-linked gilts have traditionally been considered a very safe form of investment to provide a future income stream.

> *caused by negligence or breach of statutory duty. We are also unable to confirm how many of the 14,000 cases are truly 'active' as the proceedings may have been discontinued or settled without the court being informed. As we have previously mentioned, the Directorate of Legal Services of Health & Social Care NI (which represents the health and social care trusts) indicates that, as of May 2020, there were 138 high-value cases outstanding.*[4]

The higher the discount rate, the lower the initial lump sum awarded because the claimant is assumed to be able to benefit by investing it. A lower discount rate implies lower investment returns, so the initial lump sum must be higher.

Therefore, a higher PIDR implies lower costs to defendants, the HSCNI, insurance policy holders and the taxpayer because lump sum awards are discounted more.[5] Insurance underwriters take this into account when setting premiums, which means the lower the PIDR, the more inflationary pressure there is on motor and liability insurance premiums. This can impact on the affordability of insurance premiums for health professionals (including GPs), for motorists, and for businesses. As the Justice Minister, Naomi Long MLA, has acknowledged:

> […] *higher awards of damages are ultimately funded by businesses and consumers through higher insurance premiums, and by the taxpayer through higher payments made directly by, for example, the health service*.[6]

[4] Letter from the Justice Minister to the Committee for Justice date 10th February 2021: http://www.niassembly.gov.uk/globalassets/documents/committees/2017-2022/justice/primary-legislation/damages-bill/dept-correspondence/3-r-20210210-min-of-just-letter---damages-bill-acc-pass2.pdf

[5] Ministry of Justice (2017) Setting the Personal Injury Discount Rate – Impact Assessment https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-impact-assessment.pdf

[6] Department of Justice (2020) *The personal injury discount rate: How should it be set?* pg 3

2.1 The Personal Injury Claims Process

Establishing liability

Most personal injury claims involve an allegation that the defendant has acted negligently. It is possible for a claim to be based on other grounds, such as strict liability. Strict liability covers situations where someone, such as the manufacturer of a consumer product, may become liable to pay compensation without any investigation into whether they acted wrongfully. This usually applies to injuries arising from:

- defective products;
- abnormally dangerous activities; and
- wild animals.

For a personal injury claim based on negligence to be successful, the claimant must be able to prove three elements. These are:

• that the defendant owed the pursuer a 'duty of care';

• that there has been a breach of this duty (negligence); and

• that the breach caused the harm complained of (causation).

A duty of care can be said to exist where it is reasonably foreseeable that a party's actions or omissions are likely to cause harm to another party.

The Claims Process

Once liability has been established, it is necessary to work out what quantum (amount) of compensation is appropriate. When calculating an award of compensation, the courts will consider various categories of loss. These can, broadly, be divided into:

- **General damages**: compensation awarded for pain, suffering and loss of amenity. Loss of amenity means the inability to complete activities, either temporarily or permanently, e.g. being unable to pursue certain hobbies or socialise with friends.
- **Special damages**: compensation awarded to cover the financial losses and expenses incurred as a result of an accident or negligent medical treatment.

Personal injury claims can either be commenced in the County Court or the High Court depending on the value of the claim. The County Court deals with all claims up to the value of £30,000 while the High Court deals with all claims over that amount.

The role of the insurance industry

A majority of defendants are represented by insurance companies. Therefore, in most cases, defendants will have insurance to underwrite the risk of causing someone a personal injury. Motorists and employers are required by law to have insurance against certain risks. Other forms of insurance such as public liability insurance are also common. Public liability insurance is a type of business insurance that covers the cost of claims made by the public that happen in connection a business' activities.

It is possible that a defendant may not have insurance to cover the injury in question and would be expected to engage a solicitor to represent them.

Insurance is based on risk, with insurance companies receiving premiums against various risks. The potential cost of a serious injury claim is incorporated into every insurance policy, so a very low PIDR could put inflationary pressure on local insurance premiums whereas a higher rate could lead to cost savings for consumers.

The Claimant

Those injured early in life are likely to receive the biggest compensation awards as they are more likely to be reliant on their compensation payments to meet their future needs for their life expectancy. They are often substantial compensation awards, covering a 20 to 60-year period.

Claimants receiving awards for shorter periods are less able to protect against market volatility, for example, those who are injured later in their lives may only require compensation for a few years.

3 UK Wide Developments

The Lord Chancellor set the rate for England and Wales and Northern Ireland under *Wells v Wells* at 2.5% in 2001, and Scottish Ministers did the same for Scotland in 2002, meaning that there was a uniform rate across the UK.

In 2012, there was a joint UK-wide consultation on reviewing the rate in each jurisdiction under the *Wells v Wells* framework. This was followed by the joint commissioning of a report by an expert panel to advise on how the rate should be set under that framework, but that did not reach any clear consensus.

In 2017, the rates in England and Wales and in Scotland were reduced to -0.75%.[7] The significant drop from 2.5% to -0.75 was reflective of the change in market conditions from 2001, which assumed a much lower rate of return on ILGs. The insurance industry expressed dissatisfaction at the sharp reduction in the rate, while it was welcomed as long overdue by those representing claimants. It has been observed that:

> *working out what the rate should be is a technical and demanding exercise. It is also controversial. Almost any change in the rate is likely to provoke different and opposite reactions from claimants and defendants*.[8]

The change of rate was expected to have significant financial effects on claimants, some of whose awards were expected to increase significantly. When introducing the new rate, the Lord Chancellor acknowledged that:

> *There will clearly be significant implications across the public and private sector. The Government has committed to ensuring that the NHS Litigation Authority has appropriate funding to cover changes to hospitals' clinical negligence costs. The Department of Health will also work closely with General Practitioners (GPs) and Medical Defence Organisations to ensure that appropriate funding is available to meet additional costs to GPs, recognising the crucial role they play in the delivery of NHS care.*[9]

In Northern Ireland, the absence of a functioning Assembly from January 2017 to January 2020 meant that the rate remained unchanged. From this point on, the rate has been at considerable divergence from the rates in the other UK jurisdictions.

Also in March 2017, there was a further joint consultation by the Ministry of Justice and the Scottish Government on how the rate should be set in the future. The consultation paper

[7] Lord Chancellor (2017) Discount Rate Statement of Reasons https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/594972/discount-rate-statement-of-reasons.pdf

[8] Ministry of Justice and the Scottish Government (2017) *The Personal Injury Discount Rate, How it should be set in future* https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting_documents/discountrateconsultationpaper.pdf

[9] Lord Chancellor's Written Ministerial Statement, 27 February 2017: https://questions-statements.parliament.uk/written-statements/detail/2017-02-27/HCWS503

illustrated the financial effect that a decrease in rate to -0.75% would have on lump sum payments:

> *The effect of a change in the discount rate is so pronounced because of the working of the principles of compound interest on payments to be made over potentially very long periods. For example, if £100k is invested in a portfolio with an average annual real return of 2.5%, the portfolio will have a real value of £128k after ten years and £269k after 40 years. Invested in a portfolio with an average annual real return of minus 0.75%, the real value of the £100k will be £93k in ten years and £74k in 40 years. That is, a negative return (with respect to inflation) erodes the real value of the portfolio and the effect is greater the longer the term of the investment. This means that, if the investor needs £100k in 10 years, in real terms, he or she should invest £108k if expected to invest in a portfolio with a minus 0.75% real return. If the investor needs £100k in 40 years, in real terms, he or she should invest £135k at the same real return. The difference in capital requirement is particularly pronounced in times of low interest rates*.[10]

The consultation paper also provided the following case study for illustrative purposes:

> *An 18-year-old claimant who suffers a catastrophic injury in a road traffic accident is rendered quadriplegic. She requires 18 hours of daytime care, a night sleeper, some one-off equipment costs and increased care needs in later life. The annual care costs of such a claimant could typically exceed £100k. At 2.5% the total award of a claimant of this type of claim would receive a lump sum of maybe £5m to £6m. At a minus 0.75% discount rate this award could be around £9m, meaning perhaps a 60% increase in the lump sum. The impact of a change in the discount rate can still be significant for older claimants whose earnings potential may suffer post-injury. A claimant aged 38 at the date of trial, with a predicted retirement age of 67 suffers an injury and is left with a disability after the accident. Due to permanent disability, the claimant suffers immediate income loss of (only) around £1k per year. However, owing to post-accident vulnerability on the labour market assumed by the courts for disabled individuals, much of the post-injury earnings is routinely ignored for the sake of calculating earnings compensation. Consequently, the earnings compensation lump sum of such a claimant would be £215k based on a discount rate of 2.5% using standard actuarial tables. The award would approach £350k if the discount rate were minus 0.75%, which means around 60% increase in the lump sum award.*[11]

The Office for Budget Responsibility calculated that the reduction in discount rate from 2.5% to –0.75% would increase insurance premium tax receipts by ‘around £0.1 billion a year as the increased costs for the insurance industry, particularly in the motor sector, are passed on in higher premiums’.[12]

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[10] Ministry of Justice and the Scottish Government (2017) *The Personal Injury Discount Rate How it should be set in future*, pg 11

[11] Ibid pg 12

[12] Office for Budget and Responsibility, Economic and Fiscal Outlook (March 2017), p 96, Box 4.2

The Government's response to the Consultation was published in September 2017 which included the following proposals:

> *There is clearly a need for a fairer and better framework for the setting of the discount rate. The Government intends to make the following changes to the law:*
>
> *a. The rate is to be set by reference to expected rates of return on a low risk diversified portfolio of investments rather than very low risk investments as at present; and in assessing those rates the actual investment practices of claimants and the investments available to them should be considered. This will make the rate more realistic.*
>
> *b. The principles for the setting of the discount rate should be set out in statute.*
>
> *c. The rate is initially to be reviewed promptly after the legislation comes into force and, thereafter, at least every three years, with that period being re-set when the rate is changed. Reviews will be completed within 180 days of starting. This will avoid overlong delays between reviews, which will make changes in the rate more predictable and manageable.*
>
> *d. The rate is to be set by the Lord Chancellor with advice from an independent expert panel (other than on the initial review which would be by the Lord Chancellor with advice from the Government Actuary). HM Treasury will, as at present, also be a statutory consultee for all reviews. The panel will be chaired by the Government Actuary and include four other members having experience as an actuary, an investment manager and an economist and, finally, experience in consumer investment affairs. e. It will continue to be possible to set different rates for different types of cases, including by reference to the length of the award*.[13]

Subsequently, both England and Wales and Scotland decided to deviate from the principles under *Wells v Wells* and adopted new legal frameworks in 2018 and 2019 respectively. The Scottish Government believed it was appropriate to move away from the approach of setting the rate by reference to returns on ILGs because it was 'clear that this can lead to the chance of significant levels of over-compensation'.[14]

In 2019, under its new framework, the Lord Chancellor set a new rate of –0.25% for England and Wales, while in Scotland, following a review of the rate under its new framework, the rate remained at –0.75%.

[13] Ministry of Justice (2017) The Personal Injury Discount Rate How it should be set in future- Response: https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-web.pdf

[14] Scottish Government (2018), Damages (Investment Returns and Periodical Payments) (Scotland) Bill: Policy Memorandum: https://archive2021.parliament.scot/S5_Bills/Damages%20(Investment%20Returns%20and%20Periodical%20Payments)%20(Scotland)%20Bill/SPBill35PMS052018.pdf

4. Comparable arrangements in other UK Jurisdictions

The key differences between the two legislative frameworks are that the assumed portfolio of investments and the adjustments to be made for taxation and management costs are prescribed in Scotland, but are left to judgment in England and Wales.

4.1 England and Wales

The framework for setting the rate for England and Wales is provided in section A1 of and Schedule A1 to the Damages Act 1996[15] as amended by the Civil Liability Act 2018[16]. It provides wide discretion for the Lord Chancellor in setting the PIDR but the overriding assumption is of 'low risk' investment.

The Lord Chancellor prescribes the rate in secondary legislation, having consulted an expert panel and the Treasury. The expert panel consists of the Government Actuary, another actuary, an economist, a person with experience of managing investments, and a person with experience in consumer matters as relating to investments.

In setting the rate, the Lord Chancellor must have regard to the actual returns that are available to investors and the actual investments made by investors of damages, and must make appropriate allowances for taxation, inflation and investment management costs.

In England and Wales, there is a five-yearly review. Each review must begin within the five-year period following the conclusion of the last review, and must be completed within 180 days.

4.2 Scotland

The framework for setting the rate for Scotland is provided in section B1 of and Schedule B1 to the Damages Act 1996 as inserted by the Damages (Investment Returns and Periodical Payments) (Scotland) Act 2019.[17]

The rate is set by Government Actuary. The rate is not brought into operation by secondary legislation, but by the Government Actuary's report being laid by Scottish Ministers before the Scottish Parliament.

In Scotland, there is also a five-yearly review. Each review must be started immediately after the five-year period since the previous review began, and must be concluded within 90 days.

In advance of each review, Scottish Ministers must be satisfied that the notional portfolio remains suitable for investment by a hypothetical investor. If they are not satisfied, the detail of the portfolio and the standard adjustments can be amended by regulations.

[15] Damages Act 1996: https://www.legislation.gov.uk/ukpga/1996/48/contents
[16] Civil Liability Act 2018: https://www.legislation.gov.uk/ukpga/2018/29/section/10/enacted
[17] Damages (Investment Returns and Periodical Payments) (Scotland) Act 2019: https://www.legislation.gov.uk/asp/2019/4/contents

It is presumed that there will be a single discount rate but Scottish Ministers may make regulations to require that more than one rate should be set, specifying the circumstances to which each rate is to relate. If there is more than one rate, a separate review is conducted to determine each rate.

The rate must reflect the rate of return for a notional portfolio of investments over a 30-year period, making allowance for inflation. The notional portfolio is as shown in the table below.

Table 2. Notional investment portfolio[18]

cash or equivalents	10%
nominal gilts	15%
index-linked gilts	10%
UK equities	7.5%
overseas equities	12.5%
high-yield bonds	5%
investment-grade credit	30%
property (heritable or moveable)	5%
other types (e.g. infrastructure, commodities, hedge funds and absolute return funds)	5%

Two standard adjustments are then made to the rate of return on the notional portfolio: a deduction of 0.75% to take account of expenses; and a further 0.5% to reduce the likelihood of undercompenastion.[19] A hypothetical investor is someone who:

- will invest the damages as properly advised;
- who is reliant on the damages to meet the full cost of the losses and expenses for which they have been awarded; and
- whose objectives are that the damages will meet all those losses and expenses and be exhausted at the end of the period for which they were awarded.

There is scope for more than one rate to be set.

[18] Ibid, Schedule B1
[19] Ibid

5 The Current Framework in Northern Ireland

Currently, the Department of Justice has the power to set the rate, in consultation with the Government Actuary and the Department of Finance under section 1 of the Damages Act 1996.[20] At present, the 1996 Act does not specify how the discount rate should be set so the rate is determined by applying the legal principles established in *Wells v Wells*. [21]

Until May 2021 the rate remained at 2.5% from when it was originally set in 2001 by the Lord Chancellor, before the devolution of justice functions to the Department of Justice in 2010. One of the issues with that rate was, for many years, the rate of return on low-risk investments was well below 2.5%, meaning that the level of compensation received by claimants was effectively over-discounted.

The Department of Justice considered the evidence obtained from the consultation and analysis in the other UK jurisdictions since 2017 which 'found that, while claimants should be treated as more risk averse than ordinary prudent investors, in reality they would be advised to invest in a low-risk diversified portfolio rather than very low-risk ILGs alone'.[22] Therefore, it concluded that setting the rate under *Wells v Wells*, risked over-compensation of claimants and a consequential unfair financial burden on public bodies, business and consumers. In view of this, the Department proposed that the legal framework for setting the rate in Northern Ireland should be changed so that it is no longer tied to *Wells v Wells*.[23]

In 2020, the Department consulted on options for a new legal framework for setting the discount rate. It identified the main groups that would be impacted by a change in rate as follows:

- *Claimants (persons who have been awarded damages in compensation for personal injury).*
- *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.*
- *Consumers (persons who purchase insurance policies, e.g. motor insurance, to insure themselves against the cost of damages).*
- *Businesses (individual businesses which purchase insurance policies, e.g. public liability insurance or motor insurance, to insure themselves against the cost of damages).*

[20] Damages Act 1996, Section 1: https://www.legislation.gov.uk/ukpga/1996/48/section/1

[21] Damages (Return on Investment) Bill Explanatory and Financial Memorandum: http://www.niassembly.gov.uk/globalassets/documents/legislation/bills/executive-bills/session-2017-2022/damages-bill/efm---damages-return-on-investment-bill---as-introduced.pdf

[22] Ibid

[23] Ibid

- *Insurance companies (providing insurance to groups 3 and 4).*[24]

However, the Department stated that it was not possible for it to quantify the costs and benefits of different frameworks for setting the PIDR because:

- there were no available records of the details of damages awards in the courts, or settlements reached out of court;
- it was not possible for the Department to quantify the impact of higher or lower damages awards on insurance premiums; and
- the actual rate set under any new framework is impossible to know as it will be set based on data available at that time.

Although the screening exercise by the Department only examined the policy for providing a legal framework to establish the rate, a number of respondents to the consultation highlighted that*:*

> *reducing the discount rate would have a detrimental impact on health services. In particular, the Department of Health noted 'serious consequences' for health and social care by virtue of increased expenditure on clinical negligence claims, and the cost of indemnity of GPs possibly becoming unaffordable, with resulting implications for recruitment and retention'.*[25]

Following the consultation, three options for a new legal framework for setting the personal injury discount rate were considered: (i) the model in England and Wales; (ii) the model in Scotland; or (iii) a bespoke model for Northern Ireland. Although more respondents (mainly those who represented the interests of defendants) preferred the England and Wales model, the Department decided that the Scottish model should be adopted on the basis that it is 'clear and transparent'. However, in a departure from the Scottish model, the Northern Ireland model would be based on a 43-year period rather that a 30-year period. The Justice Minister stated that:

> *The Department, however, after careful reflection, believes that the transparency and clarity offered by the Scottish model, along with the control and oversight that it will give to the Assembly, are important and valuable features for a new framework. Under the Scottish model, which our Bill adopts, the investments that a claimant is assumed to make are specified in the legislation, providing up front information to everybody about how the discount rate is calculated. Also, under the Scottish model, the rate is set by the Government Actuary. This reflects the fact that, once the parameters for how the*

[24]DOJ (2020) Personal injury discount rate – how it should be set Regulatory Impact Assessment: https://www.justice-ni.gov.uk/sites/default/files/consultations/justice/personal-injury-discount-rate-consultation-regulatory-impact-assessment.PDF

[25] DOJ (2020) The personal injury discount rate: How should it be set? Summary of consultation responses and next steps: https://www.justice-ni.gov.uk/sites/default/files/consultations/justice/summary-response-personal-injury-discount-rate.pdf

> *rate is to be set are detailed in legislation, setting the rate is an actuarial rather than a political exercise*.[26]

When asked about the use of a 43-year period during Second Stage, the Justice Minister responded:

> *Following consultation with the Government Actuary's Department, it was proposed that 43 years was an appropriate period for the purposes of the Bill, as the evidence indicates that that is the average investment period for a claimant with a lump-sum award of damages and, therefore, is an evidence-based approach. The question was reasonably asked whether varying that element of the Scottish model would have implications for overcompensating or undercompensating victims seeking compensation. The answer to that was also sought from the Government Actuary's Department and considered fully. It advised us that, in practice and assuming that all other things were equal, the difference between an assumed investment period of 30 years and one of 43 years was likely to make only a very small difference of about 0·1% or 0·2% to the rate that would be calculated. Since the discount rate is rounded to the nearest 0·25%, the material effect on the rate would either be nil or 0·25%. Therefore, the difference between 30 and 43 years is within the granularity of the scheme and would not routinely lead to overcompensation or undercompensation. I want to reassure Members about that, as it is an important point.*[27]

In correspondence with the Committee for Justice, the Minister also clarified:

> *It might be helpful to the Committee to demonstrate what difference a 0.25% change would make using an entirely hypothetical case of a thirty-year-old male with an annual requirement of £50k (to meet his loss of earnings and cost of care). In this scenario, as calculated using the Ogden Tables, a discount rate of –0.25% would mean damages of £2,987,500, but with a discount rate of 0.0% then the damages would be £2,773.000. We do emphasise that this example is purely illustrative as we don't know what the discount rate would be under the framework provided for in the Bill. While I understand that some may, understandably, want to know that level of detail, the reason we cannot provide that information is that the discount rate can only be set at the point when it is going to take effect and so any projection provided now will not be the final answer. In addition, the Committee will recall that the Scottish model provides GAD with 90 days to do this work: it is not a simple calculation, but one that takes substantial time and effort (and for which there is a charge), which is why we could not ask for this work to be done except at the point of need.*[28]

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[26] NIA OR 9th March 2021 http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2021/03/09&docID=329455#3314508

[27] Ibid http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2021/03/09&docID=329455#3314508

[28] Letter from the Justice Minister to the Committee for Justice dated 10th February 2021: http://www.niassembly.gov.uk/globalassets/documents/committees/2017-2022/justice/primary-legislation/damages-bill/dept-correspondence/3-r-20210210-min-of-just-letter---damages-bill-acc-pass2.pdf

Until the Bill is enacted, the Justice Minister announced that the PIDR would be reduced from +2.5% to -1.75% from the end of May 2021. The Minister had intended to introduced the Bill via accelerated passage but this was not 'unanimously supported by the Executive, some of whom were reluctant to dismiss the Committee Stage'.[29] Announcing this change in rate the Minister said:

> *I had hoped that legislation under the Damages Bill could be enacted by summer 2021 and a rate set under the new framework by autumn 2021. To that end I sought to bring accelerated passage of that Bill through the Assembly. However, an expeditious passage of the Bill through the Assembly has not proved possible.*
>
> *In view of this significant change in the expected time scale, the Department has reviewed its previous decision not to change the rate and, after careful consideration, decided to change it to minus 1.75% consistent with the current legal framework*.[30]

This represents a significant 4.25% reduction in absolute terms. Northern Ireland now has the lowest PIDR across the UK. This will have a considerable impact on the compensation awarded in personal injury cases. The law firm, DAC Beachcroft, believes that:

> *the value of some claims here may be more than double that of England and Wales. For example, an annual lifetime care claim of £100,000 for a 10 year old male in England and Wales, at a -0.25% discount rate would be valued at £8.7M; the same claim in Northern Ireland, at a discount rate of -1.75%, would be worth £17.7M*.[31]

In evidence to the Committee for Justice Health and Social Care Northern Ireland stated:

> *We wish to voice our concern, however, on behalf of our HSC clients that, despite the best efforts of the Committee to press ahead with plans to introduce a Bill that contains a new mechanism for setting the rate, if for any reason the passage of the Bill is delayed or is unsuccessful, the planned rate of -1·75% from 31 May will become an indefinite rather than an interim rate, and that will lead to a massive increase in compensation payouts in clinical negligence claims against the health service. That will put significant pressure on the health budget. It is incredibly difficult to forecast accurately the financial impact of the discount rate change to -1·75%, but, with the assistance of a forensic accountant, we carried out some work last year to assess a sample of our claims with a value over a defined limit. We estimated the value of additional compensation in current claims to be anywhere in the region of £40 million to £136 million. Clearly, the value of each case is difficult and challenging to predict, because it is dependent on a number of factors, including the medical evidence, the accountancy reports, the life expectancy of the plaintiff, the level of future loss claims. It is important that the Committee recognise that that is money that*

[29] NI OR 9 March 2021

[30] Department of Justice (2021) Press Release -Personal injury discount rate set to change: https://www.justice-ni.gov.uk/news/personal-injury-discount-rate-set-change

[31] DAC Beachcroft Website Article (March 2021): Interim -1.75% Discount Rate set for Northern Ireland (dacbeachcroft.com)

> *the 3 health service, in a context in which it is slowly emerging from a pandemic, could be spending on waiting lists and front-line services.*[32]

The Justice Minister has indicated that this significant reduction in rate will 'most likely result in overcompensation but that a 'new legislative framework will […] allow a stable discount rate to be set that better delivers the 100% compensation principle and provides fairness to all involved'.[33] The rate will be reviewed again once the Bill has been enacted. As it will be linked to a notional portfolio of low risk investments, it is anticipated that the rate will increase from -1.75% as it will not be based solely on ILGs.[34]

The Explanatory and Financial Memorandum of the Bill explains that:

> *The initial rate change following the first review carried out using the new methodology is likely to result in a lower rate than that currently in place. Changes in the rate as a result of subsequent reviews may result in a higher or lower rate (or the rate remaining the same), depending upon the returns achievable from the investment strategy which forms part of the methodology. However these are unlikely to be significant changes in view of the provision for regular reviews.*[35]

Subsequent rate changes may go up or down in relation to the rate at the time of any review, depending upon the returns achievable from the investment strategy which forms part of the methodology.

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[32] NIA OR 27th May 2021: http://data.niassembly.gov.uk/HansardXml/committee-26619.pdf

[33] NIA Official Report 9th March 2021: http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2021/03/09&docID=329455#3314508

[34] Correspondence from the Department of Justice to the Committee for Justice, 19th January 2021: http://www.niassembly.gov.uk/globalassets/documents/committees/2017-2022/justice/primary-legislation/damages-bill/dept-correspondence/use-this-for-19-dept-briefing-paper-no-a-and-b-annex.pdf

[35] Damages (Return on Investment) Bill Explanatory and Financial Memorandum: http://www.niassembly.gov.uk/globalassets/documents/legislation/bills/executive-bills/session-2017-2022/damages-bill/efm---damages-return-on-investment-bill---as-introduced.pdf

6. Bill and Clause Commentary

6.1 Analysis of Key Clauses

Although the provisions in the Damages (Return on Investment) Bill are quite technical, in summary, it has three main objectives.[36] As previously mentioned, it firstly provides that the task of reviewing and determining the discount rate will be carried out by the UK Government Actuary by inserting a new section into the Damages Act 1996.

Secondly, the Bill sets out a new methodology for how the rate should be calculated, which is based on the assumption that a claimant invests their damages award in a mixed portfolio of low-risk investments. That is to reflect the reality of how a claimant would be advised to invest their lump sum. It is in contrast to the current framework, which, assumes that a claimant only invests in very low-risk, index-linked gilts.

Thirdly, the Bill establishes a time frame for regular reviews of the rate. The detail of the new methodology and the time frame for reviews are provided in a new schedule to be inserted into the 1996 Act.

The Bill provides a detailed methodology for calculating the discount rate. This is based on returns from a hypothetical investor investing a notional investment portfolio over 43 years. Deductions would be made to the rate of return to take into account inflation, taxation, the cost of investment advice and to reduce the risk of under-compensation.

This section provides short commentary on the key clauses of the Bill. It draws on the oral evidence briefing given by the Minister of Justice and officials to the Committee for Justice on 28th January 2021.[37]

Clause 1 - Assumed return on investment

Clause 1, subsection (1) inserts a new section C1 into the Damages Act 1996 to replace the existing section as it applies to Northern Ireland to remove the Department of Justice's role in setting the discount rate.

Subsection (1) of new section C1 provides that a court must take into account the rate set by the rate-assessor in determining the return a claimant is expected to receive from investing a sum awarded as damages for future financial loss.

Subsection (2) preserves the ability of a court to take a different rate of return into account if it is more appropriate to do so in the circumstances of the case. However, the Court of Appeal in England and Wales held in *Warriner v Warriner* that this power is reserved for cases falling into a category of cases, or containing special features, that the Lord Chancellor did not take into account when setting the rate.[38] This power has only been exercised once

[36] Damages (Return on Investment) Bill: http://www.niassembly.gov.uk/globalassets/documents/legislation/bills/executive-bills/session-2017-2022/damages-bill/damages-bill---as-introduced---full-print-version.pdf

[37] NI OR 28th January 2021: http://data.niassembly.gov.uk/HansardXml/committee-25153.pdf

[38] Warriner v Warriner [2002] EWCA Civ 81; 2002 1 WLR 1703

and that was in the first instance decision overturned on appeal in the case *of Warriner v Warriner* itself.[39]

Subsection (4)(a) provides that the rate-assessor is the UK Government Actuary and that in the event the role is vacant, then the rate-assessor will be the Deputy Government Actuary.

Subsection (4)(b) gives the Department of Justice a power by regulations (subject to the draft affirmative procedure) to appoint a different rate-assessor, as well as somebody to deputise for that person (subsection (5)). The appointment is subject to the agreement of the person to be appointed.

Clause 2 -Process for setting rate of return

This Clause inserts a new Schedule C1 into the 1996 Act, which details how the rate-assessor is to approach the task of reviewing and setting the discount rate.

Clause 3 - Ancillary provision

Clause 3 provides a power for the Department of Justice, by regulations, to make ancillary provision. Any such regulations which amend primary legislation are subject to the draft affirmative procedure.

Powers that are subject to draft affirmative procedure, will be subject to scrutiny by the Assembly. The Justice Minister stated that this:

> *ensures political accountability for how the rate is set whilst recognising that, once the methodology by which the rate is set is detailed in legislation, the task of applying it to calculate the rate is purely an actuarial exercise.*[40]

Schedule

Schedule C1 contains 34 paragraphs and the main paragraphs provides as follows:

Paragraphs 1-3 requires the rate assessor to review the rate and provides for the timing of reviews. The first review will begin on the day that the schedule come into force and will review the rate at the time set under the existing section 1 of the 1996 Act as it applied immediately before the provisions of the Schedule are brought into operation.

The subsequent review will begin on 1st July 2024 which is intended to align with the cycle of reviews of the discount rate in Scotland. Thereafter the rate will then be reviewed every five

[39] Ministry of Justice and the Scottish Government (2017) The Personal Injury Discount Rate, How it should be set in future, pg 9 https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting_documents/discountrateconsultationpaper.pdf

[40] NIA OR 28 January 2021: http://aims.niassembly.gov.uk/officialreport/minutesofevidencereport.aspx?AgendaId=25153

years. The Department has the power to require the Government Actuary to conduct an earlier review but this would not affect the cycle of five-yearly reviews. Economic conditions can change quickly so the Bill provides for the ability to have an out-of-cycle review, if circumstances should change. The Department of Justice will be able to review the methodology and the frequency of rate reviews, to ensure that the rate still satisfies the needs of the hypothetical investor.

Under **paragraph 3**, any review is required to be completed within 90 days of the day on which it started.

Paragraph 5 provides that a review will determine whether the rate should remain the same. In carrying out a review, the Government Actuary can consult or seek advice from any person and must have regard to their views if received within a reasonable time.

Paragraph 7 sets out the basis upon which the Government Actuary is to determine the rate of return. Subject to standard adjustments and rounding of figures mentioned below, it provides that the rate should reflect the rate of return for the notional portfolio set out in paragraph 12 over a 43-year period.

Paragraph 8 gives the Department a power, by regulations subject to the draft affirmative procedure, to change the period of 43 years to another period or periods.

Paragraph 9 requires the rate to be adjusted to take account of inflation by reference to the retail prices index, or such other measure of inflation as may be prescribed by the Department in regulations subject to draft affirmative procedure.

Paragraph 10 provides for the two further standard adjustments to the rate of return:

> *a deduction of 0.75 of a percentage point to take account of the impact of taxation and the cost of investment advice and management and a deduction of 0.5 of a percentage point as a further margin 'which recognises that there is risk inherent in even the most carefully advised and invested portfolio'.*

Paragraph 11 allows the Department to change the amount of the standard adjustments by regulations subject to the draft affirmative procedure. The resulting figures may be zero or a positive number. They cannot be a negative number so the adjustments can never raise the rate of return.

Paragraph 12 sets out the notional portfolio with the types of investments and percentage holdings on which the rate-assessor is to determine the rate of return as follows:

Cash or equivalents	10%
Nominal gilts	15%

Index-linked gilts	10%
UK equities	7.5%
Overseas equities	12.5%
High-yield bonds	5%
Investment-grade-credit	30%
Property (heritable or moveable)	5%
Other types (see the examples)	5%

Examples of 'other types' are infrastructure, commodities, hedge funds and absolute return funds.

The Department can adjust the make-up of the notional investment portfolio by regulations subject to draft affirmative procedure. The notional investment portfolio moves away from the no risk approach recommended in the *Wells v Wells*. The Department has made provision for a notional portfolio created on the basis 'of portfolios described as low-risk and which the Department believes would meet the needs of an individual in the position of the hypothetical investor who is described in the legislation'.[41]

Paragraph 14 provides that the Department may make regulations (subject to the draft affirmative procedure) to define any of the types of investment included in the notional portfolio.

Paragraph 15 provides for the Department to have a power by regulations, subject to draft affirmative procedure, to change the list of investments and percentage holdings in the notional portfolio.

Paragraph 16 provides that, before any review of the rate of return under paragraph 2(1), the Department '*must consider whether regulations under paragraph 14 or 15 are necessary for ensuring that the notional portfolio remains suitable for investment in by a hypothetical investor*'.

Paragraph 17 describes a hypothetical investor as follows:

> *a recipient of damages; who will invest the damages as properly advised; who has no financial resources apart from the damages that can be used to meet the losses and expenses for which the damages are awarded and will make withdrawals from the investment fund deriving from investment of the damages; and whose objectives are*

[41] Damages (Return on Investment) Bill Explanatory and Financial Memorandum, pg 7: http://www.niassembly.gov.uk/globalassets/documents/legislation/bills/executive-bills/session-2017-2022/damages-bill/efm---damages-return-on-investment-bill---as-introduced.pdf

> *to secure that the damages will meet the losses and expenses for which they are awarded and be exhausted at the end of the period of the award.*

The hypothetical investor in the Bill is assumed to be investing over a 43-year period. Taking a long term view provides capacity for investment returns to recover from the volatility of the markets.

Paragraph 18 clarifies that, for the purposes of paragraphs 16 and 17, the damages are damages for future financial loss in an action for personal injury and they are paid in a lump sum rather than periodical payments.

Paragraphs 19 and 20 provide for the rate to be set as a percentage figure and rounded to the nearest whole number or quarter percentage point.

Paragraph 21 provides that there will be a single rate of return which will apply to all cases unless the Department by draft affirmative regulations provides otherwise. Where there should be more than one rate, a review is to be carried out separately for each rate of return.

Paragraph 22 requires such regulations to set out the circumstances in which each rate is to apply.

Paragraph 23 requires the Government Actuary to send a report to the Department when the review has finished and no later than the last day of the 90-day period for carrying out the review. The report must be dated and contain the rate determination and a summary of how the rate is calculated.

Paragraph 24 requires the Department to lay the report before the Northern Ireland Assembly as soon as practicable after it has been received. The Government Actuary must publish the report on the same day.

Paragraph 25 provides that the rate will come into effect on the day after the report is laid. **Paragraph 26** provides for the Department to reimburse the Government Actuary's costs incurred in connection with a review.

Paragraph 28 sets out the procedure for regulations made by the Department under the powers in the Schedule.

Paragraph 31 deals with regulations made under the Schedule. Sub-paragraph (1) allows regulations to make different provision for different purposes. For example, in the event that the Department makes regulations under paragraph 21 requiring more than one rate to be set, paragraph 8 (as read with paragraph 31(1)) could be used to prescribe different periods to be used in connection with the setting of the different rates. Sub-paragraph (3) provides that regulations made under the Schedule will be subject to the draft affirmative resolution procedure so they will be subject to scrutiny by the Assembly.

Financial Effects of the Bill

The Bill itself will not change the discount rate. The only direct costs arising from this Bill will be the payment for the Government Actuary's review and determination of the rate. These costs are not new as the Department currently pays to carry out the necessary statutory consultation with the Government Actuary under the existing law. Given that reviews will take place at least every five years, the payments will be more regular. The Government Actuary's Department funding model operates on a cost-recovery basis for its professional services and the Department estimates that fee will be in the region of £40,000 to £50,000.[42]

[42] Ibid, pg 7