ANNEX A

FURTHER INFORMATION TO PROVIDE COMMITTEE MEMBERS WITH BACKGROUND INFORMATION IN RELATION TO THE PERSONAL INJURY DISCOUNT RATE, TO INFORM THEIR CONSIDERATION OF THE RELATED SL1

INTRODUCTION

1. This paper is to provide Committee members with background information in relation to the personal injury discount rate, to inform their consideration of the SL1 on proposed regulations to modify the statutory parameters in the Damages Act 1996, according to which the rate is set by the Government Actuary. The SL1 and the paper should be read with the "Response to consultation and next steps" paper attached at **Annex A**.

BACKGROUND

What is the personal injury discount rate?

2. An award of damages for personal injury will include damages for any future financial losses or expenses caused by the injury, e.g. loss of future earnings, care costs and medical expenses. Sometimes these losses and expenses will run for many years into the future. An award for this type of damages is usually paid as a lump sum. The sum should be sufficient to meet all the claimant's losses and expenses but exhausted at the end of the period for which it is awarded. This flows from the legal principle that a claimant should be fully compensated for all the losses and expenses arising from the injury but no more and no less.

3. The 100% compensation principle means it is important to ensure that the claimant neither profits from investment of their damages award pending its expenditure (or the claimant would receive more than 100% compensation), nor that the sum loses its value over the claimant's lifetime due to inflation (or the claimant would be under-compensated). This is achieved by a requirement under the Damages Act 1996 for a court to apply a "discount rate", which is a percentage adjustment to the lump sum award, to take account of the assumed return on investment. A positive rate means that the lump sum is reduced, however, the rate can also be negative, meaning that the award is increased. A negative rate reflects expected returns on investment that are insufficient to overcome the effect of inflation on the value of the award.

4. As the purpose of the discount rate is to give effect to the legal principle of 100% compensation, the way in which the rate is set cannot take into account the financial impact of changes in the rate for defendants (including public bodies) and compensators, such as insurers.

5. The Damages (Return on Investment) Act (Northern Ireland) 2022 (“the 2022 Act”) amended the Damages Act 1996 to reform the way the discount rate in Northern Ireland is set, as detailed below. The rate is currently negative 1.5%, set in March 2022, the first time the rate was set under the new legislative framework.

Who sets the personal injury discount rate?

6. The rate is reviewed and determined by the Government Actuary (GA). A review of the rate must be completed by the GA within 90 days. Previously the rate was set by the Department.

How often is the rate reviewed?

7. The 2022 Act introduced a new statutory timeframe for review of the rate by the GA by providing for a five-year cycle of regular reviews. However, the next review of the rate must commence on 1 July 2024, to align Northern Ireland with the cycle of regular 5 yearly reviews of the rate in Scotland. (There is a cost efficiency in doing so because the legislative framework for setting the discount rate in Scotland is largely the same, therefore the Government Actuary’s work in reviewing the rate, for which there is a financial charge, will be common to both jurisdictions.) There is also provision for the Department to require the GA to conduct a review starting earlier than the next regular review, however, that does not disturb the cycle of regular reviews.

<u>**How is the personal discount injury rate set?**</u>

8. When reviewing and determining the discount rate the Government Actuary must use the methodology set out in the legislation. There are several elements to this as set out below.

Notional portfolio

9. The rate must reflect the expected return on the “notional portfolio” in which a claimant investor as defined in the Act is assumed to invest their lump sum award of damages. The content of the notional portfolio in terms of the types of investments and percentage holdings of each, is specified in the legislation.

Assumed investment period

10. This is the period over which the hypothetical claimant investor is assumed to invest their award in the notional portfolio. In practice, the period over which a claimant invests their award will often be linked to life expectancy. The current period of 43 years is based on evidence that was provided as part of a call for evidence in 2018 that informed the setting of the current discount rate for England and Wales in 2019. This evidence indicated that the typical life expectancy of personal injury claimants is 40–45 years.

Impact of inflation

11. The Government Actuary must make allowance for the impact of inflation by reference either to the retail prices index (RPI) or ‘some published information relating to costs, earnings or other monetary factors’ prescribed in regulations made by the Department. Thus far no other information has been prescribed and RPI was used when the current rate was set in 2022.

Standard adjustments

12. There are two standard deductions that must be applied to the rate as calculated following the steps above. One of these is to take into account the impact of taxation and the cost of investment advice and management, and is currently a deduction of 0.75%. The other is a ‘further margin’, sometimes referred to as a ‘margin of prudence’, which is intended to reflect the risk inherent in any investment, however carefully advised. The current deduction of 0.5% was based on advice from GAD

based on analysis of projected returns across the notional portfolio that, without such a margin, there is broadly a 50% chance that a claimant will not have sufficient funds to meet their needs. Applying a further margin of 0.5% reduces the risk of under-compensation to around 30–35%.

Single rate of return of multiple rates

13. At present the legislation provides for a single rate of return, however, the Department has a power to prescribe that there should be more than one rate. Dual or multiple rates might be based on the duration of an award or on heads of loss, for example, in the Republic of Ireland there is one rate for care costs and another for other losses.

Review of statutory parameters by which the rate is set

14. Before the Government Actuary begins a review of the discount rate, the Department is required by the 1996 Act to consider if regulations are necessary to amend the notional portfolio to make sure it remains suitable. The Department also has powers to make regulations to amend the other features of the statutory methodology. All regulations are subject to draft affirmative resolution procedure.

15. In anticipation of the forthcoming review of the rate, last year the Department conducted a consultation of stakeholders, and commissioned advice from the Government Actuary's Department (GAD), on the question of whether or not the Department ought to amend any of the statutory parameters or require more than one rate to be set. (The responses received from stakeholders and the Government Actuary's report are outlined in, and appended in full to, the response to the consultation and next steps paper.)

16. As the Minister has a perceived conflict interest in the personal injury discount arising from her husband's membership of a medical defence union, she delegated the final policy decisions to the Permanent Secretary.

Proposed regulations to amend the statutory parameters

17. As per the attached SL1 the Department now intends to lay draft regulations before the Assembly to:

- prescribe Annual Weekly Earnings as an alternative measure of inflation to RPI, and
- modify the Damages Act 1996 to increase the standard adjustment for taxation and investment advice and management from 0.75% to 1.25%.

18. All the other aspects of the current statutory provision for setting the rate will remain unchanged. The “Response to consultation and next steps paper” sets out the reasons for the Department’s conclusions with reference to the consultation responses and the advice from GAD.

19. Now that the policy decisions have been made by the Permanent Secretary, the Minister will bring forward the motion for approval of the draft regulations before the Assembly. If the Assembly affirms the regulations, they will come into operation on or before 1 July 2024, in time for the Government Actuary commencing the review of the discount rate. A review of the rate must be concluded within 90 days and any new rate would come into effect on the day after the Department lays the Government Actuary’s report of the review before the Assembly.