Setting the Discount Rate – Some Initial Thoughts

Today's headlines may focus on which 'side' of personal injury claims has 'won' or 'lost' with the new rate now set at -0.25% from 5 August 2019. However, the real winner may in fact be fairness. Process matters. It seems that the review system has increased transparency, consultation and evidenced-based decision-making with a view to trying to ensure that compensation is truly both full and fair to both sides.

1. When a person claims damages for injury or illness where loss is expected to continue in the future, there are two forms of award which the court has power to grant, either a periodical payment (usually annual and subject to increases linked to an index of inflation), or a lump sum or capital award.

2. Where a capital award is made, the injured person needs to be given sufficient money to ensure that the funds are only exhausted at the time when the loss comes to an end – in many cases the end of the claimant's expected life. Therefore the capital award is adjusted by a factor, which has come to be known as the 'discount rate' because for many years it was a positive percentage which had the effect of reducing the capital award because the return on investment could reasonably be expected to positive.

3. The banking crisis and subsequent financial crash ended that expectation, although the rate itself remained untouched until February 2017 when then Lord Chancellor, Liz Truss, reviewed the discount rate and made it -0.75%. This came as a surprise to many in the sector and prompted complaint from larger compensators, such as those involved with NHS claims.

4. The following political backlash led to the Civil Liability Act 2018 which set out a formal review process of the discount rate for the first time.

5. In December 2018 the Ministry of Justice issued a call for evidence to inform the setting of the discount rate, including investments available to claimants, investment advice provided to claimants, taxation, inflation, investment management costs and model investment portfolios. 40 responses were received, which, according to the summary of responses, 'often reflected the competing interests and differing perspectives of those representing claimants and defendants.' For example, there was clear disparity of opinion as to suitable investment decisions for claimants. In some areas, there was a lack of helpful evidence, particularly on the question of how claimants actually invest damages awards. Evidence from respondent organisations demonstrated that generally speaking, the larger the claim, the more it was affected by the discount rate.

6. This evidence 'directly informed the advice which the Government Actuary' provided to the current Lord Chancellor, David Gauke and also advice of Ministry of Justice officials. The statement of the outcome of the review is a model of civil service balanced language and it is difficult to see past the number of references to 'reasonableness' to work out precisely what has been decided.

7. However, there are one or two features of the statement which suggest that the Discount Rate review process is a work in progress and the next review in 5 years' time may produce a different outcome. First, there is the choice of a representative portfolio with a minority of growth assets (42.5%). Secondly, there is the choice of CPI plus 1% as the assumed inflation figure. Thirdly, and perhaps more interestingly, the Lord Chancellor has chosen to 'build in further prudence' than the Government Actuary assumptions and to take the rate of -0.25%

on the basis that this means claimants on average are twice as likely to be over-compensated as they are to be under-compensated.

8. The final point to note is the decision to reject (for now) any suggestion of dual discount rates for different types of loss because ‘at present we lack the quantity and depth of evidence required’. Therefore there is now to be a ‘consultation in due course’ to examine the prospect of dual rates in time for the next review. It seems likely that this review is more the beginning than the end of the discount rate story.

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