

Legal Update

Discount Rate under review

Introduction

The Lord Chancellor has announced a review of the discount rate for personal injury damages is underway, with the results to be announced by 31 January 2017.

The discount rate


Over recent weeks there has been a lot of focus on the proposed reforms around whiplash and the small claims track limit ("SCT"). However, as dramatic as those proposed reforms would be, the potential savings they would generate could potentially be significantly offset by the impact of a downwards reduction in the discount rate set by the Lord Chancellor. The prospect of that happening has for a long time been viewed as remote but, following an announcement by the Ministry of Justice ("MOJ") yesterday, there now appears a real possibility that the rate will be varied.

The announcement follows the MOJ contacting a number of industry stakeholders in June of this year, including the Association of Personal Injury Lawyers ("APIL"), Forum of Insurance Lawyers ("FOIL") and the Association of British Insurers ("ABI"), with a request for information relating to large loss claims. The context of the request was specifically stated to be in order to assess the impact of a variation in the discount rate.

By way of reminder, the 'discount rate' is the mechanism by which damages paid to seriously injured individuals in relation to future losses are discounted to reflect the fact of early receipt. The courts apply the discount rate to damages in order to take account of (a) the possibility that the claimant may die sooner than anticipated and (b) the fact that the claimant will receive the damages in advance of incurring the expenditure to which they relate. The level of discount differs according to two variables; the claimant's residual life expectancy and the prevailing discount rate that is set from time to time by the Lord Chancellor.

The discount rate essentially calibrates the level of discount to be applied so that it reflects the level of return that an individual can reasonably expect to achieve through investment of their damages fund. It has remained at 2.5% since it was last varied in 2001. However, the Lord Chancellor is obliged to keep the discount rate under review in line with the provisions of s.1 Damages Act 1996.

A succession of Lord Chancellors have taken various steps in relation to discharging their obligation in that regard but have never actually varied the discount rate. At one stage, APIL sought to judicially review the Government over its failure to review the discount rate. However, in recent times, the claimant lobby has gone rather quiet on this issue.



The commonly held view is that claimants no longer think a reduction in the discount rate will benefit them, particularly following Kenneth Clarke’s announcement, during his time as Lord Chancellor, that the MOJ might consider looking not only at what percentage discount rate was appropriate but also whether the underlying methodology behind the calculation of the discount rate was, in fact, appropriate.

In late 2013, the Government published a report on research carried out into how claimants invested their damages. This added very little to the debate and a response to a parliamentary question in 2014 on the subject also gave very little away. In late 2014, Chris Grayling MP (Lord Chancellor & Minister for Justice at the time) announced the appointment of three financial advisors to report on the core issues relevant to a review of the discount rate. However, the combined budget for that study was reportedly limited to £30,000 and, unsurprisingly, the study failed to bring about any immediate, substantive developments.

The more recent call for information came from the MOJ on 9th June 2016, during Michael Gove MP’s tenure as Lord Chancellor. Specifically referencing s.1 Damages Act 1996, and the fact that the Lord Chancellor is responsible for reviewing and setting the discount rate, the MOJ indicated that it was looking to improve the quality of advice to ministers by devising an analytical modelling tool. It was therefore starting a process of gathering information about large loss claims in order to populate the tool. No mention was made of re-examining the methodology behind the setting of the discount rate.

Comment

A downwards variation of the discount rate would have potentially profound consequences for insurers and other compensators alike. By way of illustration, take a 21 year old male rendered tetraplegic as a consequence of a road traffic accident who ends up with a commercial care regime involving 2 day time carers, plus a sleeping night carer, at a cost of £175,000 pa. The table below shows how his future care award would vary according to fluctuations in the discount rate:

Discount Rate	Multiplicand	Multiplier	Award
1.5%	£175,000	41.32	£7,231,000
2%	£175,000	36.11	£6,319,250
2.5%	£175,000	31.87	£5,577,250
3%	£175,000	28.39	£4,968,250

As can be seen, even a relatively modest downwards adjustment of the discount rate would potentially add six figure sums to indemnity spend on an individual catastrophic injury case. Those cases might be few in number by comparison to whiplash cases but, given the potential for a dramatic increase in indemnity spend on a case by case basis, the cumulative impact on capital reserving would be significant.

The impact of variation of the discount rate would not be limited to catastrophic injury cases. Some lower value personal injury claims, and also some disease claims, would also be impacted.



A change in the rate would alter the settlement value of any claim where future damages forms a part of the award/settlement and a multiplier and multiplicand approach is taken to the valuation of those damages.

Variation of the discount rate is, at the same time, not a step that Government can take lightly. Although the current Lord Chancellor, Liz Truss MP, is not technically required to have regard to consequences beyond the impact on claimant damages funds, she will no doubt be made aware of the significant impact a downwards variation would have. This, of course, extends beyond the insurance industry as the NHS and Ministry of Defence are significant compensators in their own right.

There will be consultation with the Treasury and Government Actuary prior to any variation of the discount rate (a mandatory statutory requirement under the Damages Act) but MOJ has indicated that that will be completed rapidly.

For the insurance industry, a key imperative must be to make clear to Government exactly what the impact of a discount rate variation would actually be. Through our connections with Government, we have been liaising with MOJ and the ABI to ensure that those making decisions are alive to the potential consequences of variation of the discount rate.

For further information or if we can assist please contact:

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