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MoJ hints that future discount rate calculation will be based on expected returns from investments made by claimants

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BY MAREK HANDZEL ON MARCH 30, 2017 INJURY, INSURANCE, LEGAL, NEWS, REGULATION

The Ministry of Justice has said that any new framework for setting the personal injury discount rate should depend on the expected returns from investments made by claimants, barely a month after changing the rate for the first time in years.

Secretary of State for Justice Liz Truss shocked the insurance industry and pleased the claimant community in equal measure in February by adjusting the discount rate for life-changing injuries from 2.5% to minus 0.75%.

However, the Government has now launched a consultation on the rate, which ends on 11 May, and is asking for views and evidence on how claimants invest their damages. It is also asking for opinions on what could be done to make the system for the setting of the personal injury discount rate “better and fairer” and whether or not the use of periodical payment orders should be favoured over lump sum awards.

It has also suggested that the use of index-linked gilts (ILGS) as a benchmark needs reconsidering due to the fact that claimants have the potential to place themselves in a better financial position "than had the incident not occurred". The MoJ says that they can do this by adopting a different investment strategy with the potential to outperform the risk-free rate.

"In practice claimants will pursue a range of investment strategies, but if on average they adopt a higher risk profile than ILGS and as a consequence have the potential for higher returns, then on aggregate the current law is at risk of overcompensating claimants," said the consultation document.

"A different balance could be struck by altering the underlying assumption that claimants adopt a degree of investment risk. By reducing or eliminating the potential for overcompensation, this could achieve a fairer balance between claimants and defendants on aggregate. The degree of investment risk would need to be calibrated appropriately so that claimants are not exposed to such unacceptably high risks that they are not able to meet their expenses over time."

The MoJ has suggested some new general principles for setting the rate which would be underpinned by the claimant's investment risk appetite.

The setting of the rate should also make sure that the lump sum payable after the application of the discount rate plus the assumed income expected to be earned should represent the full loss; and that the losses and costs assessed by the court to flow from the injury should be met on time. It should also guarantee that the losses and costs assessed by the court to flow from the injury should be met on time; and that the capital and the income assumed to be earned from the award must be exhausted at the end of the period for which the award is made.

Truss, said that the consultation, which has been published together with the Scottish Government, was also looking to find out how frequently the discount rate should be reviewed, and by whom.

"Awards of damages for life changing personal injuries are necessarily going to be very large in some cases, but in the interests of society as a whole and the services that underpin it, I want to be sure that the system of compensation is one that compensates claimants properly, but is fair to consumers, business and taxpayers," she said.

"I welcome responses from everyone interested in this topic. Subject to the responses I receive, I would propose to legislate to make sure that the way the rate is set is put on the firmest possible footing in future so that we have a better and fairer system for claimants and defendants."

Responding to the consultation, the Forum of Insurance Lawyers' (FOIL) president Nigel Teasdale, said: "The gulf in opinion across the insurance and legal sectors exposed when the new minus 0.75% discount rate rate was announced a few weeks ago demonstrated how vital it is for this framework review to be conducted.

“FOIL will be active in helping the MOJ identify a calculation methodology which is fair to victims, legally robust and which properly reflects long-term financial investment patterns, so that we achieve a formula which is sustainable and not disproportionately burdensome on any party.”

APIL’s president Neil Sugarman said that it was very important that the rate had been reduced because people with serious, life-changing injuries were not receiving the compensation they desperately needed.

“Having said that, we are always prepared to be involved in constructive debate and so we will be responding to the consultation,” he said.

“Following the insurance industry’s hysterical response to the recent rate change, we are also very encouraged by the Lord Chancellor’s obvious commitment to the fact that injured people must receive 100 per cent compensation – no more, no less.”