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Institute and Faculty of Actuaries

17 April 2023

# Ministry of Justice Call for Evidence

# Personal Injury Discount Rate: Exploring the option of a dual/ multiple rate

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

**Key points**

The IFoA welcomes the opportunity to respond to the MoJ's Call for Evidence on the Personal Injury Discount Rate, and its exploration of the option of a dual/ multiple discount rate. It is important that the methodology for setting the discount rate is both fair to claimants and practical to implement.

We have considered the MoJ's Call for Evidence from an independent, public interest perspective. In doing so we have taken a broad perspective on the public interest, considering the impact of discount rate on personal injury claimants and also on society as a whole.

For lump sum settlements, a multiple or dual discount rate may be 'fairer' for claimants than the current single rate system. There is however a balance to be struck between:

- introducing operational and legal complexity (which a dual rate may bring) that would slow down final payments to claimants; and
- a fairer solution.

A much more complex system would necessarily introduce costs (to claimant lawyers and insurers) that would ultimately be paid for by all impacted claimants and increased premiums paid by policyholders. We note that this additional pricing burden may be in part borne by those who live in more economically deprived areas which is not a socially fair outcome.

Given our analysis, we suggest that a dual rate is practically the fairest compromise. In our view none of the systems used internationally is perfect. However, the Ontario model is perhaps the closest template on which to base a UK system, is it provides a more precise match to the profile of the claimant's losses and arguably provides a fairer outcome for both claimant and defendant.

We strongly suggest that an adequate lead time is given to all stakeholders before any changes to the Ogden discount rate methodology is introduced. If a new discount rate system (dual or multiple rate) is introduced without a reasonable lead time before the change, claimants may suffer. If there is not enough lead time, all stakeholders (including lawyers and compensators) will take time to adapt their systems and processes for the changed process. Court cases could also take longer to resolve any new areas of subjectivity, and ultimately agreement on the quantum of total claimants may take far longer compared to the current system.

We believe that, for some elements of compensation, the most appropriate asset for a claimant to match the liability cash flows is a PPO. The PPO leaves the investment/ other risks with the insurer and we strongly support the use of PPOs wherever possible.


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1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Ministry of Justice (MoJ)'s Call for Evidence on the Personal Injury Discount Rate, and its exploration of the option of a dual/ multiple discount rate. As is recognised in the Call for Evidence, it is important that the methodology for setting the discount rate is both fair to claimants and practical to implement.

2. In developing our response to the Call for Evidence, we have drawn largely upon input from members of our Ogden Discount Rate Working Party. This working party is comprised of actuaries working across the general insurance industry, ranging from corporate firms and consultancies; it has been working on and estimating the impact of various different methodologies and assumptions on potential future Ogden discount rate. We have also had further input from our Periodical Payment Orders (PPO) Working Party, and wider review from members of our General Insurance Board and Standard and Consultations Committee.

3. It is important to note that, as for any IFoA response, we have considered the MoJ's Call for Evidence from an independent, public interest perspective. In doing so we have taken a broad perspective on the public interest, considering the impact of discount rate on personal injury claimants and also on society as a whole.

4. Given the above, we believe that the IFoA has an important role to play in the debate on the future methodology of the personal injury discount rate. We would therefore be delighted to discuss our response with MoJ in due course.

5. The IFoA responded to the MoJ's previous Call for Evidence on the setting of the personal injury discount rate in 2019. In that response, we set out our view that the discount rate should be derived from a risk-free rate of return, reflecting the risk appetite of a risk-free investor. Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate increases this risk. We do however note that there is a broad spectrum of wider actuarial opinion on the setting of the discount rate.

6. It is also the IFoA's view that for some elements of compensation, claimants are best served by the use of a PPO given the closer match to their liabilities and removing them from the investment and longevity risks associated with a lump sum compensation payment.

7. We acknowledge however that the Civil Liabilities Act 2018 sets out the legislative basis for determining the personal injury discount rate, including the use of a representative investment portfolio to inform the Lord Chancellor's decision. Our response to this Call for Evidence therefore reflects our views on the questions being consulted on, rather than revisiting earlier discussions on risk appetite/ risk-free rates of return.

*Note: we have answered all the Call for Evidence questions in the Appendix to this letter, but we would summarise our key themes as follows:*

8. For lump sum settlements, a multiple or dual discount rate may be 'fairer' for claimants than the current single rate system.

9. **There is however a balance to be struck between:**

    - **introducing operational and legal complexity (which a dual rate may bring) that would slow down final payments to claimants; and**
    - **a fairer solution.**

10. A much more complex system would necessarily introduce costs (to claimant lawyers and insurers) that would ultimately be paid for by:

    - all impacted claimants as the complexity would mean that cases would take longer to resolve as it would take longer for claimant lawyers to estimate the impact of the Ogden discount rate; and

    - increased premiums paid by policyholders - and in particular policyholders aged under 30 and over 60 who are disproportionately involved in severe accidents that result in bodily injury claims impacted by the Ogden Discount Rate.

11. We note that this additional pricing burden may be in part borne by those who live in more economically deprived areas which is not a socially fair outcome. This increased cost would arise as introducing complexity will lead to increased operational costs which in turn gets passed to these customers. **In our view it is important the MoJ considers this point explicitly.**

12. If a new discount rate system (dual or multiple rate) is introduced without a reasonable lead time before the change, claimants may suffer. If there is not enough lead time, all stakeholders (including lawyers and compensators) will take time to adapt their systems and processes for the changed process. Court cases could also take longer to resolve any new areas of subjectivity, and ultimately agreement on the quantum of total claimants may take far longer compared to the current system. **We strongly suggest that an adequate lead time is given to all stakeholders before any changes to the Ogden discount rate methodology is introduced**.

13. Given our analysis, we suggest that a dual rate is practically the fairest compromise.

14. For a dual rate, a switchover point within the range of 7-15 years may be optimal. In our view none of the systems used internationally is perfect. However, the Ontario model is perhaps the closest template on which to base a UK system, is it provides a more precise match to the profile of the claimant's losses and arguably provides a fairer outcome for both claimant and defendant.

15. Advantages of dual/ multiple discount rates may be as follows:

    - if the discount rate varies with duration:
        - dual/ multiple rates could more accurately reflect expected investment behaviour and tax charges;
        - this may lead to fairer outcomes for claimants and for compensators;
    - if the discount rate varies depending on the heads of loss:
        - dual/ multiple rates could more accurately reflect the different inflation measures and tax charges;
        - they could also lead to increased data capture for compensators;
    - the legislative framework also already allows for the introduction of a dual/multiple rate system.

16. Disadvantages of dual/ multiple discount rates may be as follows:

    - if the discount rate varies with duration:
        - the short-term discount rate may be more volatile than the current single rate;
        - this could lead to the need for more frequent reviews of the short-term rate at least;
        - the availability of PPOs as an alternative method of settlement could mean that a dual/ multiple rate is unnecessary;
        - a dual rate as previously modelled by the Government Actuary Department (GAD) could also produce a short-term rate which is too low or too high;
    - if the discount rate varies depending on the heads of loss:

  - there is an argument that each head of loss would need a separate rate which could become very complex;
  - it could also see re-allocation of amounts between heads of loss category to maximise/ minimise compensation by claimant/ defendant representatives;
- multiple rate structures will introduce additional complexity, including the need for an increased number of assumptions to be made;
- there will be associated implementation costs and increased operational complexity.

17. The IFoA ran a survey of insurers/ reinsurers[1] affected by the discount rate during 2022 and it was clear that there were no survey respondents who were immediately able to implement a dual rate approach.

18. Compensators have become accustomed to a framework of periodic updates to a single discount rate. For example, in an IFoA survey of insurers and reinsurers from 2022 only 6% of respondents stated that their processes and systems are not at least partially in a position to automatically cope with a future change in discount rate.

19. However, the same survey showed that over half of the respondents have systems and processes which would not be able to cope automatically with a dual discount rate at all. Almost all other respondents explained that their existing systems would only ‘partially’ be able to cope with a dual discount rate.

20. Our belief is therefore that a lead-in period will be highly beneficial to minimise operational delays in payments to claimants and also minimise costs of the change passed onto policyholders through insurance premium increase.

21. The survey also asked whether respondents would prefer a dual rate: 50% of respondents said they would, whilst 50% said they would not.

22. PPOs are an under-utilised form of compensation which can provide fair outcomes to claimants and compensators. Changes in the discount rate that affect the amount of lump sum compensation on offer also impact the take-up of PPOs. Any revision of the discount rate framework should aim to encourage increased take up of PPOs as they offer a solution that best meets the restitutio in integrum principle without under- or over-compensating claimants.

*Note: we also have a number of wider points relevant to this Call for Evidence, but not directly related to the questions being consulted on, as follows:*

23. As the MoJ will be aware, the Road Traffic Act requires UK drivers to have unlimited third party liability. The reinsurance excess of loss market currently removes the unlimited liability from the balance sheets of UK insurers and moves it to the balance sheets of, in general, foreign reinsurers.

24. Reinsurers will wish for a compensation framework that they can predict, in order that the excess of loss protection is available at a reasonable price. A discount rate that changes too frequently and by too large a degree will reduce the attractiveness of the very reinsurers that provide the capacity to cover the losses where the discount rate is most relevant. Hence a degree of certainty/ predictability in relation to the discount rate is important in maintaining a well-functioning excess of loss reinsurance market in the UK motor insurance market.

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[1] See: https://www.actuaries.org.uk/system/files/field/document/A4%20%20Ogden%20Working%20Party.pdf and https://www.actuaries.org.uk/learn-and-develop/online-learning-video-resources/resources-practice-areas/general-insurance-non-life

25. The Call for Evidence focuses on personal injury claims processed through the insurance industry, such as injuries through road traffic accidents. As the MoJ will also be aware, a further source of personal injury – and corresponding claims – arises through the NHS. The corresponding claims process (and financial implications) here is clearly different, although we recognise that this topic is outside the scope of this MoJ Call for Evidence.

Should you want to discuss any of the points raised please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Mohammad Khan
**Chair, IFoA Ogden Discount Rate Working Party**

Matt Saker
**President, Institute and Faculty of Actuaries**

## Appendix: Responses to Questions within Call for Evidence

**Question 1: Do you have a preferred model for a dual/ multiple rate system based on any of the international examples set out in the Call for Evidence paper (or based on your or your organisations experience of operating in other jurisdictions)?**

**Question 2: What do you consider to be the main strengths and weaknesses of the dual/ multiple rate systems found for setting the discount rate in other jurisdictions?**

*Note: the points below cover both questions.*

1. In general terms, we consider that desirable features of a dual rate model would include:

   - discount rates that achieve fair outcomes for claimants and defendants, and reduce the risk of significant under - or over-compensation reducing the need for incorporating judgemental prudence margins;
   - discount rates aligned with the duration of cash flows;
   - discount rates that capture the:
     - term structure of interest rates;
     - varying inflation expectations in the short and long term; and
     - varying capacity of claimants to take investment risk as a function of their investment horizon.

2. Features of a dual rate model that might be undesirable would include discount rates that:

   - remain stationary despite changes in underlying economic conditions;
   - change too frequently, creating uncertainty for claimants and defendants;
   - are disconnected from realistic investment returns;
   - assume conservative or aggressive risk-taking relative to the investment horizon;
   - are based on irrational investment assumptions.

3. Further undesirable features include:

   - inflation adjustments that reflect monetary policy targets, rather than widely accepted measurements of expectations;
   - undue complexity that is not warranted by additional benefit.

4. This last point is especially important. What is key is that any revised Ogden discount rate methodology uses a methodology that is fair to claimants receiving a lump sum settlement. Making a change to the Ogden discount rate methodology will inevitably mean that in the short term (for example in the first year) it will cause a delay in payments to claimants, as claimant advisors work to ensure they get the right payment for their clients under the new system. There is a balance that needs to be made between paying the claimants in full quickly - as these are individuals with severe injuries - and applying the ‘technically correct’ Ogden discount rate.

5. The **Ontario** model of a short-term rate for damages in the first 15 years after trial, and a longer-term rate for losses thereafter, provides stability for the longer-term rate. In the Ontario example, the long-term rate has never changed since the framework was established; it does however blend in the impact of current economic conditions on shorter-term losses. This approach provides a more precise match to the profile of the claimant’s losses and arguably a fairer outcome for both claimant and defendant. However the short-term rate in the Ontario model is quite volatile and reviewed every year. This carries the risk of causing delays to claim settlement, with one side or the other always

waiting for a more favourable discount rate which might be just around the corner. The floor of zero to the short-term rate is somewhat arbitrary and detracts from fair compensation, although in recent years it has promoted stability of the short-term rate.

6. The multiple rate system used in **Hong Kong** uses only a single rate for a given claim, depending on the overall claim duration. This creates a step change depending on duration, with claims only just under the duration threshold potentially settling at a very different rate to similar claims just over the duration. This creates apparent unfairness and could lead to prolonged disputes about the duration of losses, life expectancy etc. Using three rates rather than two has some (limited) benefit in terms of additional precision/ fairness, but arguably this is outweighed by the added complexity it causes.

7. In **Jersey**, separate rates are used for short and long duration claims, but for any given claim a single rate is used for the whole claim. This has the same disadvantages of a step change as set out for Hong Kong above.

8. In **Ireland**, different rates are used for different heads of damage. This could arguably introduce greater precision and fairness. However, the differences in appropriate rates for different heads of damage are likely to be relatively minor (compared to the differences arising from duration). For example, over a long time period it is unlikely that the inflation rate for future care costs will be very different from a more general rate of future earnings inflation, for instance. This is illustrated by the fact that the two rates in Ireland only differ by 0.5%. In any case, the vast majority of future losses typically relate to care costs. This system seems to be just as complex as using dual rates based on duration, but with far less benefit.

9. None of the systems used in the international examples is perfect, but the Ontario model is perhaps the closest template on which to base a UK system. This could be improved by a less frequent cadence of review for the short-term rate to avoid the issue whereby a rate change is always on the horizon and one party or the other stands to gain by delaying for a few months, and by removing the floor of zero. Conversely, the long-term rate in Ontario has perhaps been too stable, and some level of change over time might have been expected.

10. We also note that none of the systems in use in other jurisdictions adopts the 'blended' approach to dual rate. Ontario adopts a 'switched' approach whilst Jersey and Hong Kong use a 'stepped' approach. As outlined above, the 'switched' may be fairer and may create less risk of anomalous outcomes than does the 'stepped' approach. The 'blended' approach is a more theoretically correct approach than the 'switched' model. However this greater accuracy comes at the cost of significantly increased complexity. Whilst it should still be possible to derive a set of tables or a computer program to calculate the appropriate multiplier in any given case, this would necessarily involve some element of calculation, rather than simply looking up a value on a table as practitioners today are used to. In deciding on the appropriate framework for a dual rate model, the benefits of greater accuracy under the blended approach must be weighed against the greater ease of use of the switched model.

**Question 3: What do you consider is the optimal point for the switch-over from a short to a long-term rate on a duration-based dual rate model? Please give reasons with accompanying data.**

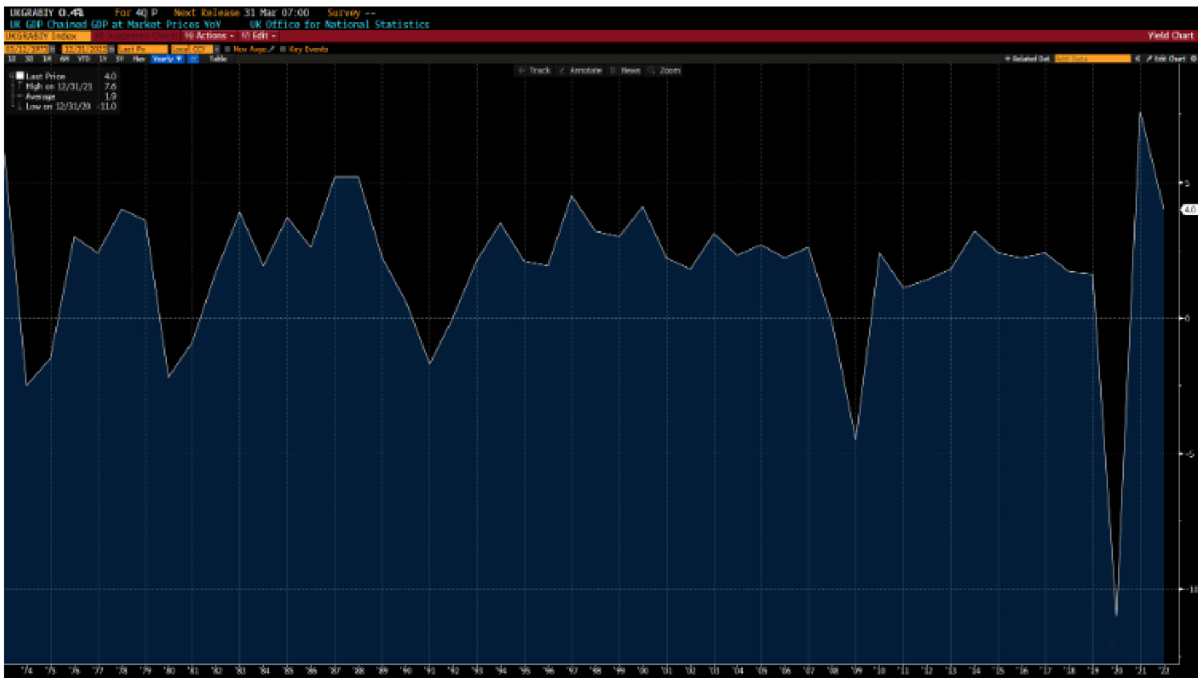
**Question 4: What would you consider an absolute minimum and maximum point for the switch-over between two rates to be?**

*Note: the points below cover both questions.*

11. An optimal point for the short to long term rate switchover might be ten years. The average economic cycle (measured as time between calendar years of negative GDP growth YOY at market prices) in the UK since 1970s has been 9.6 years, although cycle lengths can vary greatly, as the chart below

shows. A switch-over point a little shorter or longer than this optimal point might be acceptable: within a range of perhaps 7-15 years.

**Chart 1**




12. Switchover points outside of the reasonable range would risk either the short or long-term rate having to reflect a more heterogeneous mix of claimant investment strategies, and so reduce the benefit of having a dual rate.

13. If the switch-over point is too short (for example, 5 years), this would result in two very differentiated segments:

- the very short period before switch-over (0 to 5 years), in which any form of risk taking would be discouraged for lack of investment horizon;
- the longer period after switch-over (over 5 years), which would likely lead to differentiated investment strategies for different investment horizons, so the longer-term rate would have to reflect a very heterogeneous mix of strategies.

14. Conversely, if the switch-over point is too long (say 20 years), this would result in heterogeneous grouping in the first segment.

15. Furthermore, using the 10-year point as a pivot has historically minimised the average dispersion of standard deviations of nominal interest rate term premium, which would then reduce the gap between the short and the long-term rates. The table below provides quantitative evidence of this:

| | 0 to 5 | 5 to 30 | 0 to 10 | 10 to 30 | 0 to 20 | 20 to 30 |
|---|---|---|---|---|---|---|
| Standard deviation | 1.4 | 2.4 | 2.2 | 0.5 | 3.1 | 0.1 |
| Average | 0.8 | 0.3 | 1.6 | 0.3 | 2.4 | 0.0 |
| average standard deviation | 1.9 | | 1.4 | | 1.6 | |

Note: 0 refers to Bank of England's Base rate. The other tenors are gilt yields to maturity at the end of each quarter

**Question 5: If a dual rate system were to be introduced, would you advocate it was established on the basis of the duration of the claim with a switchover point, on duration based on length of claim or its heads of loss (or a combination of the two)?**

16. Based on the work of our Ogden Discount Rate Working Party, a dual rate based on duration of claim with switchover would be preferred, as per the Ontario example described in our response to Questions 1 and 2. We believe this is fairer than a step-change to duration which creates unfairness and potential satellite litigation around the cliff edge. This was referred to in relation to Hong Kong and Jersey, also in our response to Questions 1 and 2. Head of loss is a less material factor in establishing the discount rate, so a dual rate on this basis would be less beneficial (but equally complex) compared with a dual rate based on duration. This is considered in relation to our discussion of the system in Ireland, again in our response to Questions 1 and 2.

**Question 6: In dealing with volatility of markets over the short-term is it a reasonable assumption that short-term rates in a duration-based system should be more variable and set at a lower rate; and long term rates more stable and set at a higher rate?**

*Note: in this section we are referring to nominal rates and exclude all impact from inflation adjustments.*

17. Short-term rates are likely to be more volatile and will depend on the current economic cycle.

18. The longer-term rate would be expected to be more stable, reflecting the lower volatility historically observed in long-term nominal and real interest rates and the mean-reverting features of risk premia.

19. Historically, the term structure of nominal interest rates has been upward sloping. What this means is that short-term interest rates have typically below long-term ones. However, there are periods where short-term rates have been higher than those in the long-term, as it is the case currently. If the short-term rate is reviewed regularly and reflects current economic conditions, there should be no need for extra prudence to be built into it to reflect the volatility.

20. The basket of assets considered should differ between claims for a short lifespan and those where the claimant seeks to invest over the longer-term. It could be argued that claimants with a short-term duration might typically seek less volatile and more liquid investments, to preserve capital value. On the other hand, longer-term investors have more freedom to accept short-term volatility and seek a higher return that at least counters the impact of inflation over a long period.

21. Therefore a short-term basket of assets might imply a lower nominal expected return than a long-term basket of assets. The current basket of assets used by GAD is effectively a mixture of both short- and long-term investors. If GAD goes down this approach, we might expect to see movement away from that average basket in both directions.

**Question 7: If short-term rates are more volatile, should frequency of review be increased?**

22. Both short and long-term rates should always be reviewed simultaneously because, although short-term rates are likely to be move volatile, the impact of a large change in short term rates on claims is small, whereas the impact of a change, even a small one, in long term rates, can be very significant.

23. The incremental costs of reviewing both rates simultaneously might be thought to be low. There is an argument for short-term rates to be reviewed more frequently than is currently the case to ensure they reflect current conditions. However, there is a balance to strike as too frequent reviews encourage delays in claim settlement with one side or the other waiting for the next rate change in order to obtain a more favourable settlement. The current maximum review period of 5 years is not unreasonable and feels like the right period. We are conscious that we are going through a period of

rapidly changing market conditions and some might argue that a move to perhaps 3 years might allow rates to better reflect changing economic conditions. More generally, a proactive assessment of whether the discount rate should be reviewed before the review update deadline may be appropriate, although this would require pragmatism from an administrative perspective.

24. The MoJ should, however, reflect on the fact that shortening the review period would encourage delays in claim settlement which may not, in our opinion, be in the interest of claimants. However, we also note that the review period of 5 years is a maximum length of time between reviews, and the Lord Chancellor can launch an earlier review if there are significant changes to the economic environment.

**Question 8: What would you regard as the advantages of a dual/ multiple rate system?**

25. In line with the 'restitutio in integrum' principle, the ideal theoretical compensation framework would be based on a personalised discount for each and every claimant that perfectly replicates the investment return that they would earn and recognises the duration of their claim, their specific heads of loss and other claimant features like their appetite for investment risk and capacity-for-loss.

26. This would clearly be too complicated to implement, would result in vastly increased costs that would ultimately be borne by claimants and all insurance policyholders paid through their insurance premiums.

27. In reality, a discount rate framework needs to be more practical than this with a series of simplifying approaches which do not result in gross unfairness to claimants or compensators through under- or over-compensation. The major advantage of a dual rate system is that it provides improved accuracy in providing 100% compensation (i.e. not under- or over-compensation). In doing so, there is less need for prudence margins to be added by the Lord Chancellor to the Ogden rate proposed by the GAD as was the case in the last Ogden rate review in 2019.

28. Where the discount rate varies with either duration or heads of loss the legislative framework already allows for the introduction of a dual/multiple rate system.

29. Where the discount rate varies with duration:

    - a dual/ multiple rate more accurately reflects expected investment behaviour. Claimants with a longer investment horizon are able (all other things equal) to accept greater volatility in investment returns, leading to higher expected returns; whilst those claimants with shorter investment horizons typically invest in less volatile asset classes that have corresponding lower return expectations;
    - this leads to fairer outcomes for claimants and for compensators in that those with shorter horizons are required to take less risk to generate the required investment return; whilst those with longer horizons can take more risk/ volatility to generate the target return so there is a better match between risk/ return requirements meaning that in comparison to a single Ogden discount rate. Claimants with shorter claims are less likely to be under-compensated and those with longer claims are less likely to be over-compensated. IFoA Working Party analysis [2] as presented at the IFoA's GIRO conference in 2021 shows the level of over/ under compensation; see Chart 2 below;
    - as recognised in the Ontario consultation that led to dual rates: 'Even greater equity between plaintiffs would be provided by interest rates specified by a full yield curve. A full yield curve

[2] See: https://www.actuaries.org.uk/learn-and-develop/online-learning-video-resources/resources-practice-areas/general-insurance-non-life

expands the number of tiers from two to 30 or more by specifying a separate interest rate for each individual year of payment' Page 2 of evidence submitted to subcommittee reviewing the Ontario discount rate, 30 July 2020. Report published 20 April 2021 [3];

- a longer-term discount rate is more likely to be stable over time, giving more certainty to claimants, compensators and the Courts which means settlement discussions for long-term claims happening in the run-up to an Ogden rate review might be less contentious;
- more stable long-term rates may also give more certainty to compensators such as insurers;
  - this may allow them to set future reserving commitments with more certainty;
- there is already support amongst members of the community representing claimants for dual/ multiple rates. In an IFoA survey of specialist regulated financial advisers who advise claimants, the advisers indicated support for a dual rate structure. For example, one indicative verbatim comment was: 'A variable discount rate…would encourage the right behaviours for both claimants and defendants alike'.

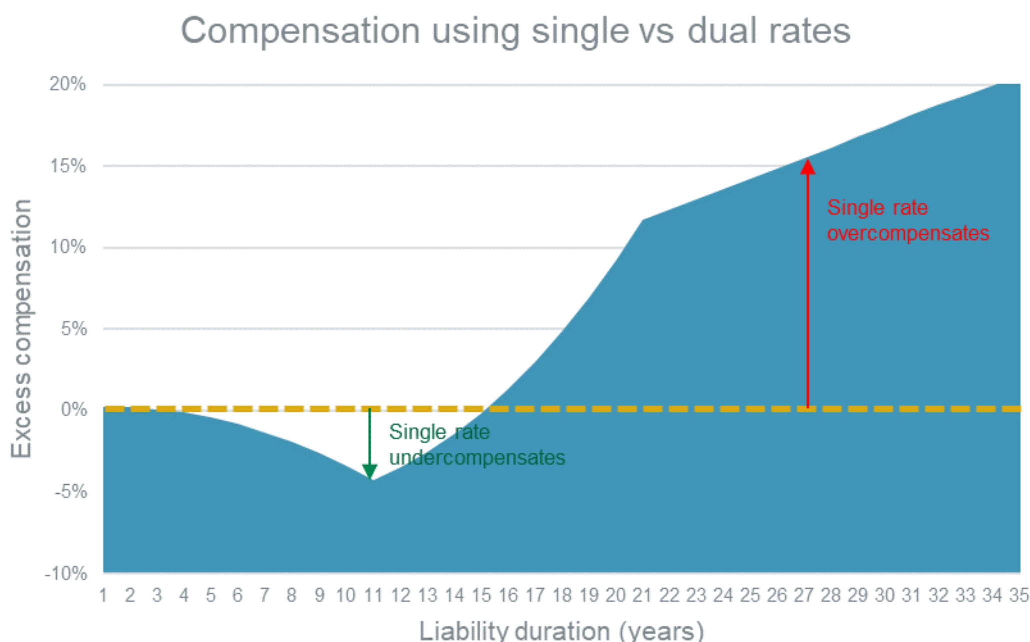
30. Where the discount rate varies depending on the heads of loss:

- dual/ multiple rates may more accurately reflect the relevant differing inflation measures. For example, future earnings growth for loss of future earnings versus future care inflation for costs of care. In other words, a heads of loss based dual/ multiple rate may be better able to address longer-term care needs appropriately;
- incorporating heads of loss into the discount rate could result in increased data capture for compensators. This could lead to benefits for insurers as they may have more granular detail to enable them to reserve/ set capital requirements more accurately.

[3] See paragraph 448 on page 121 from the Canadian Institute of Actuaries; link to the report here: https://www.ontariocourts.ca/coa/en/crc/report-crc-2021.pdf

31. Chart 2 below shows the degree of under/ over compensation based on a single rate. For claimants with expected lifespan over 15 years, using a single rates produces different levels of overcompensation, whereas the opposite occurs to claimants with an expected lifespan under 15 years. This illustrates the unfairness of using a single rate system.

**Chart 2: Compensation Using Single versus Dual Rates**




**Question 9: What would you regard as the disadvantages of a dual/ multiple rate system?**

32. We note the following disadvantages of dual/ multiple rate system where the discount rate varies with either duration or heads of loss:

- the current single rate is simple to interpret and administer for lawyers, advisers, claimants and compensators. A single rate has greater simplicity and transparency. It avoids confusion and uncertainty in the lump sum to be awarded;
- in particular, the single rate makes it easy to produce Ogden tables from which compensation can be derived. The tables are relatively easy to interpret and communicate. It is straightforward for compensators to model a single rate when assessing reserving, pricing, capital and reinsurance needs;
- multiple rate structures will introduce additional complexity (whether the multiple rate is for different heads of loss or different time periods). In particular:
  - Ogden tables may be more difficult to produce/ interpret for users;
  - results may be more difficult to discuss at Joint Settlement Meetings and more difficult to communicate between claimants, their representatives, compensators and the Courts;
- personal injury litigation is already very complex, and a dual/ multiple rate system would add an additional layer which could make it harder for claimants and their families to make decisions on settlements and investment of damages. It could therefore take longer to settle claims given this uncertainty, and more ‘back and forth’ between insurers and claimants;
- the increased complexity of the dual/ multiple rate structure will require an increased number of assumptions to be made by compensators and claimant representatives, as well as by GAD. This will add uncertainty to the calculations;

- a new system will have implementation costs for the Courts, GAD, claimant representatives and also for compensators. This will introduce further operational complexity for compensators. Moving to a new system would impose burdens on practitioners. This includes IT system costs for both claimant practitioners and compensators, implications for compensators in regard to reserving calculations and it would likely necessitate additional work in updating the Ogden actuarial tables to assist parties and the courts in calculating damages in individual cases. The additional costs are 'lost to the system' and therefore potentially worsen outcomes for both claimants and compensators.

33. We note the following further disadvantages of dual/ multiple rate system where the discount rate varies by head of loss:

- awards are often already made under several heads of loss and there are arguments that each of these heads would need a separate discount rate which could become very complex;
    - furthermore, it could result in re-allocation of amounts between heads of loss category to maximise/ minimise compensation by claimant/ defendant representatives.

34. We note the following further disadvantages of dual/ multiple rate system where the discount rate varies by duration:

- whilst a long-term discount rate might be stable over time, the corollary is that the short-term discount rate is likely to be more volatile than the current single rate. This is likely to lead to the need for more frequent reviews of the short-term rate at least;
- more frequent reviews and expectations about future rate changes could also impact on when claims are submitted and settled which might result in delays for claimants and compensators, as people may delay settlement in the hope of improved compensation outcomes. This already happens but could become more frequent/ impact more claims if rate reviews become more frequent;
- a dual/ multiple rate risks an increase in litigation, or higher costs. Settlements may be delayed further by the introduction of a new process and such an increase in time to reach settlement may outweigh the benefit accrued from having more targeted rates;
- in theory, the availability of PPOs means that a dual/ multiple rate is unnecessary - a lump sum combined with a PPO should ensure that claimants' short and long-term needs can be met appropriately without moving away from a single rate framework. PPOs can cater for earnings-related losses as well as care costs (although in practice this is seldom done);
    - in practice however, take-up rates for PPOs are low relative to what might be expected for a host of reasons - which includes the attractiveness of lump sum payments for compensators and claimant representatives, which is not always to the benefit of the claimants themselves;
- a dual rate as previously modelled by GAD could also produce a short-term rate which is very low. Although this may be reasonable depending on the prevailing rates of return at the time the rate is set, it may also have significant immediate impacts on compensators. This is because past premiums, from which the first awards under the new rate will have to be paid, would have been calculated on a different discount rate;
    - however, this may be offset by long-term claims which could be smaller than is currently the case;
    - the net effect is very dependent on the actual short / long-term rates that would be adopted.

35. When considering a long term and short term rate, consideration should be given to long term vs short term economic outlook as well as long term vs short term investor behaviour.

**Question 10: What do you consider would be the specific effects on implementing and administering the discount rate if a dual/ multiple rate is introduced?**

36. If there is insufficient lead time given to introduce the new discount rate system, it is very likely to lead - in at least the first year - in a significant delay in agreeing compensation amounts and any personal injury cases that go to Court.

37. Advisors to claimants and compensators will need time to ensure that they are calculating the compensation accurately. With a new, more complicated system, this will inevitably lead to delays. Furthermore, if there are any areas of subjectivity, this may lead to further delays especially in any cases that go to Court as time will be required in the Court to assess what the process or assumption should be for the new subjective areas.

38. If the dual rate is based on different heads of loss, then compensators will need to upgrade their systems to potentially capture different heads of loss for reserving and pricing - if this is not already captured.

39. If the dual rate is based on multiple time periods, then compensators will need to amend their systems (for example those used to handle claims) to take this into account.

40. In addition to amending systems, insurance and reinsurance companies providing compensation will need to enhance their reserving, pricing and capital management models.

41. GAD will need to produce a new set of Ogden tables or, if not possible, design and operate an Ogden calculator into which the different time period details/ heads of loss/ etc can be entered; this will need to be hosted on a website.

42. In the short-term, a change is likely to require additional project work for all parties to become familiar with the new discount rate framework which in turn could delay settlement discussions.

43. Depending on how complex the implementation is, all those working with discount rates will need significant upskilling to understand the new discount rate regime, without which there could be errors that may have an adverse impact on claimant outcomes.

44. Over time, there will be more work understanding the uncertainty for every future discount rate review given the extra complexity in the dual/ multiple rate approach.

45. The IFoA ran a survey of insurers/ reinsurers affected by the discount rate during 2022 and it was clear that there were no survey respondents who were immediately able to implement a dual rate approach: '**No respondents** said that their companies have **quantified** the impact under a **dual rate scenario'.**

46. The **timing** of the announcement of the next discount rate(s) may also have administrative implications. For example, an announcement close to (just before or just after) 31 December 2024 could have a significantly impact on insurers/ their auditors' year end processes. We suggest that any change should ideally avoid the November – February period to minimise impact on both year end reporting and reinsurance renewal period processes.

**Question 11: In addition to specific effects, do you consider there will be additional consequences as a result of implementing a dual/ multiple rate?**

47. It is plausible that a dual/ multiple rate based on different time periods might typically result in the Ogden rate going up for long time horizons, and possibly down for short-time horizons relative to what would be the case with a single rate. This may make PPOs more attractive for the most severely injured claimants which in turn could lead to more PPOs being settled. This could lead to fairer outcomes between claimants and compensators as there is less risk of under or overcompensation with a PPO, and it also reduces the investment/ mortality/ inflation risk taken on by claimants. We see this as a positive outcome.

48. As already mentioned, if there are more frequent rate reviews in future, this could lead to one side or the other waiting for the next rate change in order to obtain a more favourable settlement with resulting delays in agreeing compensation.

**Question 12: If a dual/ multiple PIDR were to be introduced would it be helpful to provide a lead in period to prepare processes, prepare IT changes etc. and if so, how long should this be?**

49. A lead-in period would be extremely helpful. As we already mentioned in answers above, the change is significant for advisors to claimants and compensators and many of them may not yet be ready to deal with such a significant change.

50. Without a lead in period, there is almost certainly going to be significant delays compared to the current system in agreeing and compensating claimants in full. This would clearly not be in the interests of claimants.

51. Operationally for compensators, they are familiar with a framework of periodic updates to a single discount rate. For example, in an IFoA survey of insurers and reinsurers from 2022 noted that: ‘In line with last year’s response, only 6% of respondents stated that their processes and systems are not at least partially in a position to automatically cope with a future change in discount rate’.

52. However, the same survey showed that over half of the respondents have systems and processes which would be unable to cope automatically with a dual discount rate at all, and almost all other respondents replied that their existing systems would only be ‘partially’ able to cope with a dual discount rate.

53. The survey also asked whether respondents would prefer a dual rate; 50% of respondents said they would, whilst 50% said they would not.

54. Our belief is that a lead-in period will be highly beneficial. This should be in two stages:

    - first of all, the MoJ should announce whether a dual rate system will be adopted and what the structure of that system will look like;
        - e.g. duration-based or heads of loss base, and if duration-based dual or multiple-period rate and what the switch-over methodology and point will be;
    - the second stage should confirm the actual discount rate to be used. This will reduce the impact of settlement delays including those due to waiting for a more favourable settlement.

55. We anticipate firms will need a minimum lead in period in total of six months, to update claims handling systems, as well as reserving, pricing and capital management models and to provide the appropriate staff training. We understand through discussion that there are many firms that have yet to do any impact analysis on adopting a dual/ multiple rate framework.

**Question 13: What do you consider would be the effects of a dual/multiple rate on a claimant's investment behaviour and what would this mean for the design of a model investment portfolio?**

56. The IFoA does not have expertise specifically regarding claimant's investment behaviour because this information is difficult to obtain, however, in this response we have made educated comments in order to provide a response to this question.

57. Under both single and dual/ multiple rate structures, short-term claimants may be more inclined than long-term claimants to choose less volatile and more liquid investments (not a 'passive investment approach' per se[4]) than longer-term ones. If the short-term rate within a dual rate system is lower than the single rate (as might normally be expected), then short-term claimants may have more certainty (than under a single rate) that their lump sum will be sufficient.

58. With the single rate approach, claimants may have been taking on more investment risk than their risk appetite/ capacity-for-loss would otherwise allow for, as they were attempting to generate sufficient return to ensure their lump sum would be sufficient. On the other hand, if they had chosen less volatile investments (with corresponding lower expected returns), they may have been implicitly accepting that their lump sum compensation would be insufficient to meet their needs.

59. Under a dual/ multiple rate approach, longer-term claimants may prefer to take more investment risk in order to generate higher returns as their lump sums may be smaller than under a single rate framework (if the long-term rate increases relative to the single rate). However, it is often considered that longer-term investors have a greater ability to accept volatility as returns revert to the mean over long-term investment horizons.

60. Our discussions with financial advisers are not conclusive on the actual investment choices made by claimants as each claimant has their own risk appetite and, along with broader family support structures, different capacity-for-loss which is taken into account in the advice process. This means that even those with long-term claims may choose to invest in very low risk asset classes due to having a low appetite-for-risk. In reality, we believe the risk appetite of claimants and their capacity-for-loss is more likely to drive their investment choices than the level of discount rate and corresponding lump sum payment that they receive.

61. Consequently, under a dual rate framework, it may be necessary for GAD to design two model investment portfolios, one representing a short-term investor and the other a longer-term investor, when proposing the level of Ogden discount rates.

62. On a wider point we suggest it would be helpful to perform some historic back-testing on the representative portfolio used to set the current (single) discount rate, to understand how that portfolio has performed in practice, compared with expectation. Any conclusions from such a comparison may be helpful in informing the design of model investment portfolios for dual/ multiple discount rates. It would however be important to undertake such back-testing over a suitably long period: the previous GAD analysis assumed an average duration of 43 years, so responding to poor performance of the representative portfolio over the tumultuous period of the last 2-3 years might not be appropriate.

[4] (Page 87 of MoJ Call for Evidence says 'For example, a short-term claimant may take a more passive investment approach while a long-term claimant, whose award is larger and designed to last for a lengthy period, may take a more active and riskier approach and consult a financial adviser.' )

**Question 14: What do you think would be the effects of a dual/ multiple rate on drawing up assumptions for tax and expenses when setting the discount rate?**

63. Tax and expenses assumptions would be dependent on the methodology for the dual/ multiple rate but there is likely to be a greater range of appropriate assumptions given investment behaviour would change with a dual/ multiple rate.

64. If the multiple rate were set for different heads of loss, then loss of future earnings should allow for projected income tax at marginal rates or be based on net income after tax. We do not otherwise have a view on the assumptions used for tax and expenses, other than to note that a passive investment approach (which often has more volatile investment returns and is more suitable for long-term investors) has lower costs and could be more appropriate for the longer-term claimants than for shorter-term claimants. This means there might be differing expense assumptions for the different time periods incorporated within a dual/ multiple rate.

65. On the other hand, if the appropriate portfolio for short-term investors is less complex than that for longer-term investors, this may result in a corresponding difference in the appropriate expense assumption. For example, claimants may agree reduced ongoing advice charges with financial advisers or choose not to use an adviser or investment platform to manage their investments.

**Question 15: What do you consider would be the effects of a dual/ multiple rate on analysing inflationary pressures and trends when setting the discount rate?**

66. The effect of the discount rate will depend on the approach taken. If the discount rate varies for different heads of loss, then differing inflation assumptions should be used (e.g., loss of earnings might use an earnings-related metric).

67. If, however, the discount rates vary by duration, then a short-term discount rate may be calculated allowing for short-term anticipated inflation. A more stable long-term average inflation assumption may be used for longer-term discount rate periods, which may more closely resemble the Bank of England inflation target.

**Question 16: What do you consider would be the effects on claimant outcomes of a dual/ multiple rate being adopted for setting the discount rate?**

68. Claimants may face increased complexity in understanding the final award under a dual/ multiple rate approach. This could lead to the possibility of inappropriate claimant decisions being made. More expertise will also be required in determining the appropriate award.

69. There may be potential delays to claim settlement if there is limited expertise available; this may be particularly pronounced if the lead time granted before any change to the discount rate approach is limited.

70. On the other hand, a dual/ multiple rate could lead to a ‘fairer’ lump sum award, with fewer instances of over/ under compensation. It may provide a better reflection of the investment of lump sum awards in practice.

**Question 17: If a dual/multiple rate was adopted would it be possible to return to a single rate in future reviews, or would a move be too confusing and complex and seen as irrevocable?**

71. In our view it would be possible to a single rate in future, but we do not think it would be desirable. As we have noted, dual/ multiple rates would lead to fairer outcomes for the claimant and we struggle to

see the benefit to any stakeholder once a move to dual/ multiple rates has been made to then move back to a single rate.

72. For example, all stakeholders would need to adapt their IT systems to hold additional data and be able to accommodate new processes systems once the move to dual/ multiple rates is made. There may be significant complexity in this, especially if data points at different rates are not maintained. This cost would essentially be lost if a reversion to a single rate were to occur.

73. There would be a significant investment of time required across a number of fields (legal, claims, actuarial etc) to adapt to dual/ multiple rate (e.g. training), so reverting to single rate following transition would waste much if not all of this effort.

74. This does not however preclude the possibility that the short and long-term rate might be coincidentally equal at some points in time.

**Question 18: What do you consider the respective advantages and disadvantages of adopting multiple rates would be, when compared with either a: single rate; or dual rate?**

75. In relation to a single rate, advantages of multiple rates would be similar to those of a dual rate: there would be fairer outcomes for claimants.

76. In relation to a single rate, disadvantages of multiple rates would be:

- complexity leading to delays in payment to claimants;
- increased costs for all stakeholders that would ultimately be borne by claimants and all purchasers of insurance as well as to society of claims from the NHS;
- disproportionate impact in insurance pricing on those policyholders who tend to be involved in accidents leading to severe bodily injury claims that involve the use of the Ogden discount rate (i.e. the young and old);
    - this disproportionately impacts young and old people in more deprived economic areas which is not a fair social outcome;
- possibility of multiple cliff edges.

77. In relation to a dual rate, advantages of multiple rates would be:

- fairer and smoother distribution;
- allows for the nature of short/long term yields.

78. In relation to a dual rate, disadvantages of multiple rates would be:

- complexity leading to delays in payment to claimants;
- increased costs for all stakeholders that would ultimately be borne by claimants and all purchasers of insurance as well as to society of claims from the NHS;
- disproportionate impact in insurance pricing on those policyholders who tend to be involved in accidents leading to severe bodily injury claims that involve the use of the Ogden discount rate (i.e. the young and old);
    - this disproportionately impacts young and old people in more deprived economic areas which is not a fair social outcome;
- possibility of multiple cliff edges.

**Question 19: If a heads of loss approach were adopted, what heads of loss should be subject to separate rates – care and care management costs, future earnings losses, accommodation, or any other categories?**

79. This question will be best responded to by a claims management expert. However, using too many heads of loss may add complexity for little benefit.

**Question 20: Introducing a dual/ multiple PIDR could result in increased levels of complexity for both claimants and compensators. Do you agree with the assumption that this complexity will stabilise and ease once the sector adapts to the new process?**

80. The complexity should reduce once systems are embedded and stakeholders get used to working with the new system. However, a high level of expertise will be required.

81. Complexity will remain as rates will need to be updated to reflect an ever-changing economic environment. A dual/multiple rate system will also add complexity to anticipating how the rate may change in future and calculating appropriate scenarios.

82. There may be ongoing complexity related to any grey areas where there might be arguments between claimant and compensator as to which rate should apply in a particular circumstance.

**Question 21: The Government remains interested in exploring the use of PPOs in relation to high value personal injury settlements. We would therefore welcome any submissions, data and/or evidence stakeholders may have in relation to the effective use of PPOs?**

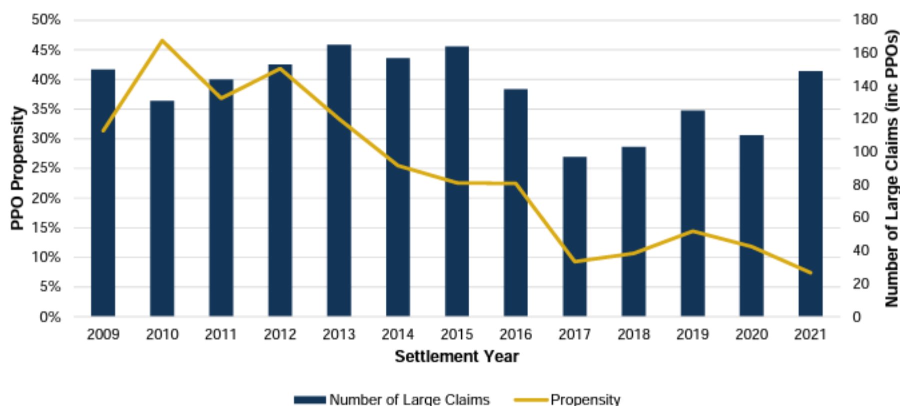
83. PPOs are an excellent mechanism to help to meet the restitutio in integrum principle in that the uncertainty of claimant longevity and investment return is removed from the equation. Indeed, compensators such as the NHS and Motor Insurers' Bureau prefer to settle large liability claims as PPOs. However, there are valid reasons why other compensators and claimants might prefer lump sums over PPOs and so mandating a one-size-fits-all approach to personal injury compensation would not be appropriate.

84. From a claimant point of view, whilst the longevity and investment return risks are removed through a PPO compared with a lump sum settlement, there remain limitations arounds the extent to which the compensation award truly reflects the liabilities faced. Assumptions are made upon settlement in respect of various elements, in particular the regular payment amounts, inflation index used and forecast changes in the level of the regular payment due to changes in the severity of injury or claimant circumstances which may differ from those actually experienced by the claimant.

85. The IFoA PPO Working Party that collects data via a qualitative and quantitative survey of insurers and reinsurers each year. It has been producing research papers on PPOs since 2010 and continues to publish the results of its surveys to the public each year. The research is available to the public on the IFoA's website.

86. Part of the survey analysis includes commentary on the PPO propensity – i.e. take up rate – measured as the % of large personal injury claims that settle as a PPO each year. The working party analysis shows the strong positive correlation between level of Ogden rate and PPO propensity when comparing the propensity in settlement years 2016 and prior with 2017 and post. This is intuitive given the lower Ogden rate results in higher lump sums which makes them more attractive relative to PPOs. In particular slide 20 of PPO working party presentation at the GIRO 2022 conference held in November 2022 (the most recent PPO working party publication) contains the chart below which shows PPO propensity over time compared to the number of large claims. It is worth noting that the

PPO working party produces propensity analysis on various bases in an attempt to make each year more comparable, with the chart below showing the raw unadjusted propensity. The detailed definitions behind the metrics and the various bases can be found within the presentation slides and industry report and will not be reproduced here.




87. The PPO working party analysis shows that the average PPO propensity was approximately 25% between 2014-2016, reducing significantly to circa 11% in 2017 when the Ogden rate reduced from 2.5% to -0.75%, with an increase to circa 15% in 2019 when the Ogden rate increased to -0.25%. The analysis reproduces the PPO propensity assuming that the lump sum settlements were valued on a 2.5% Ogden rate, which reduces the number of claims classified as large and increases the calculated propensity, which is presented in the chart below. The comparison suggests that adjustment for this numerical Ogden impact closes some of the gap in propensity, with the remainder likely driven by behavioural impacts with lump sums being more attractive relative to PPOs.

**Question 22: Do you agree that using a higher PIDR to calculate the real rate of return in settlements which include a PPO element would result in a more appropriate way to adjust nominal investment returns for future inflation?**

88. Settlements including a PPO element would provide additional cashflow security and thus potentially allow claimants to adopt more investment risk (justifying use of higher discount rate) for any lump sum component. However, in practice, there are likely to be a number of other factors that determine how claimants actually invest such as their own risk appetite. In addition, the extra complexity this would introduce would arguably outweigh any potential benefit.

**Question 23: What impact would a dual/ multiple rate system have on protected characteristic groups, as defined in the Equality Act 2010?**

89. A high proportion of claimants will be classified as disabled and therefore achieving a fair level of compensation is important for their needs.

90. Increased complexity in calculating the discount rate could lead to some groups being disadvantaged if they are not able to access professional advice. However, legal advice should be available and complexity exists in the current system too.