Press release: Reforms to compensation payouts announced

The announcement follows a pledge made by Ministers in February to consult on whether there was a fairer way to set the “discount rate” in future.

The reforms will make sure personal injury victims get the right compensation – and could also see significant savings for motorists through lower car insurance premiums and the NHS.

The discount rate is the percentage used to adjust compensation awards for victims of serious personal injury, according to the amount they can expect to earn by investing it.

The adjusted awards should put claimants in the same financial position they would have been in had they not been injured – they should receive neither more nor less than 100% compensation.

In February this year the discount rate was reduced from 2.5% to minus 0.75%, in accordance with the law.

As a result, Ministers launched a full consultation in March and analysis of the feedback, along with other research, has indicated that claimants often take more investment risk than the law currently assumes.

The changes, proposed in draft legislation, mean the rate would be set by reference to “low risk” rather than “very low risk” investments as at present, better reflecting evidence of the actual investment habits of claimants.

The proposals will also ensure the rate is reviewed more regularly in future – at least every three years – and extend the expertise available to the Lord Chancellor in carrying out the reviews by creating a role for an independent expert panel in the process.

Ministers are keen to engage on the issue ahead of a Bill being introduced into Parliament.

Lord Chancellor and Justice Secretary David Lidington said:

> We want to introduce a new framework based on how claimants actually invest, as well as making sure the rate is reviewed fairly and regularly.
>
> In developing our proposals, we have listened carefully to the views of others, and we will continue to engage as we move forward.

While it is difficult to provide an estimate, based on currently available information if the new system were to be applied today the rate might be in the region of 0% to 1%.

The move will help ensure that claimants continue to receive full compensation, but will significantly reduce overpayment by more reliably reflecting how the money is actually invested.

Notes to editors

- In February the discount rate was reduced from 2.5% to minus 0.75%, leading to larger awards and concerns in some quarters that the current law provides more compensation than needed to claimants. The consultation, launched in March, sought to address those concerns by collecting views on how to make the system better and fairer.
- It is a well-established principle of law that individuals should receive 100% compensation for losses suffered as a result of personal injuries that are not their fault. The personal injury discount rate is a percentage used to adjust the lump sum awards for future losses, costs and expenses received by victims of life-changing injuries to account for the amount victims can expect to earn by investing their awards. The discount rate applied to the compensation for future financial loss (such as loss of future earnings and care costs) should ensure that people receive the 100% compensation that they were awarded – no more or less – by taking into account what they are likely to earn on that money before they are expected to have spent it.
- The current framework for setting the discount rate uses real yields from Index Linked Gilts as a proxy for the returns that can be expected from a very low risk investment strategy. However, drawing on expertise from financial advisers, the Government has found strong evidence that in practice claimants are advised to and invest in low risk diversified portfolios.
- In February this year, in accordance with the law, the discount rate was lowered from 2.5% to minus 0.75%. At the same time, a number of pledges were made, including a consultation to consider whether there is a better and fairer way of setting the rate in future. That framework is contained in the draft legislation published today.
- When the current discount rate was announced in February, the Prudential Regulation Authority (PRA) estimated that the reduction in the discount rate from 2.5% to minus 0.75% could cost insurers around £2 billion a year, albeit with a wide range of uncertainty around this figure [1]. PWC predicted an increase of £50-£75 on an average comprehensive motor insurance policy [2]. The Government has set aside an extra £1.2 billion a year to meet the expected additional costs to the public sector (notably to NHS Resolution) [3]
- The proposals make clear that:

a) The rate is to be set by reference to “low risk” rather than “very low risk” investments as at present, better reflecting evidence of the actual investment habits of claimants.

b) The rate should be reviewed at least every three years

c) The Lord Chancellor will consult a panel of independent experts when setting the rate.

- Under the proposed legislation, the discount rate will be set by reference to rates of return on “low risk” rather than “very low risk” investments as at present. This is based on evidence gathered during consultation. Where they expressed a view, consultees advised that claimants do not invest in very-low risk portfolios such as one entirely comprising Index Linked Gilts and many suggested that it is reasonable to expect claimants to invest in low-risk portfolios instead. Representative low-risk portfolios have been constructed from exemplars obtained from consultation responses and a survey of wealth managers and financial advisors. The returns expected from these portfolios are examined in the report by the Government Actuary’s Department and impact assessment published with the draft legislation.
- The proposals envisage that a review of the discount rate would be started within 90 days of the new law coming into force. On this review the Lord Chancellor must consult the Government Actuary and HM Treasury (as at present). On all further reviews the role of the Government Actuary as a statutory consultee will be taken by an independent expert panel (which will be chaired by the Government Actuary). The Government Actuary heads the Government Actuary’s Department, which is a non-ministerial department, whose mission is to support effective decision-making and robust reporting within government as the first choice provider of actuarial and specialist analysis, advice and assurance.
- The draft legislation will be published on gov.uk later today and will be open for public comment.

[1] Office for Budget Responsibility (March 2017). Economic and Fiscal Outlook [2] For example, Cecil N, Lynch R (27 February 2017). Insurance payouts shake-up ‘to land NHS with £1 bn bill and hit drivers’. Evening Standard [3] Economic and fiscal outlook, March 2017