CONSULTATION DOCUMENT ON SETTING THE DISCOUNT RATE

DEPARTMENT OF JUSTICE AND EQUALITY

JUNE 2020

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Introduction

The Minister for Justice and Equality, Mr Charlie Flanagan TD, invites interested parties to make submissions in relation to the issue of the personal injury discount rate, also known as the real rate of return, and how it should be set. This rate is used by the courts in cases involving catastrophic personal injuries to determine the size of an award necessary to compensate a person for damages for future loss.

The basis for this consultation is Recommendation 24 of the Cost of Insurance Working Group Report on the Cost of Motor Insurance, which requires the examination of the setting of the discount rate in personal injury lump sum awards. The recommendation includes two action points – a review of the matter and the subsequent submission of a Report to the Working Group on the outcome of the review.

It should be noted that, in engaging in a public consultation on the issue, the intention is not to change the fundamental principle that a claimant should be fully compensated but to ask a series of questions about what if anything needs to be done in order to update the current system of setting the discount rate. In this regard, there are two key issues on which we are seeking views -

(i) In determining the discount rate, should it be left to the Judiciary to decide on the appropriate rate on a case by case basis, or should the existing section 24 of the Civil Liability and Courts Act 2004 be amended by introducing principles and policies to allow the Minister for Justice and Equality to determine the rate and review at intervals thereafter?

(ii) As has happened in the UK, is there a need to update the investment strategy that a plaintiff is assumed to take in determining the discount rate?

On the basis of views received, the Minister will be able to consider how to take this matter forward. The consultation will be open for a period of eight weeks. Details of how to make submissions in respect of the consultation are contained in the consultation paper.

Section 1: Background Information

Section 1 of the consultation document provides background information regarding the purpose of the discount rate, current legislation, recent case law, periodic payment orders and developments in the U.K. This information may be of benefit to stakeholders in responding to the questions raised in section 2.

1.1 Purpose of the discount rate

The discount rate is used in a relatively small number of very severe personal injury cases where substantial compensation, involving the calculation of future special damages, is awarded. The purpose of the discount rate is to convert an assumed future stream of income into a present lump sum. In the case of a personal injury award, this lump sum, when invested at a particular rate of return, will theoretically provide a person with the appropriate level of compensation for his/her level of injury as determined by the Courts.

The idea is to strike a rate that reflects, from an objective perspective, what a person might be reasonably expected to generate on this money, when invested, over a period of time to ensure that the level of compensation paid is appropriate. Therefore with a discount rate such as say 4%, the assumption is being made that a person can make a 4% return on his/her lump sum by investing it. To ensure that the person is appropriately compensated to the correct level, there would be a need to set the lump sum at a level to get to this theoretically correct amount. If a lower discount rate of say 2% is set, then the assumption being made is that the investment returns are not as good, and therefore in order to reach this appropriate level of compensation, a larger lump sum will have to be awarded.

The difficulty with making this determination is that if the rate is set too low, there is a risk of overcompensation, as the assumption is being made that the person to whom the award is being made will invest his/her lump sum in a conservative manner. However, this may not always be the case as some people may have a higher risk appetite and consequently are prepared to invest in assets that generate a better return. In such a case, if their investment strategy is successful, they will get more, by way of investment return, than the level of the original award. The converse is that too high a discount rate means that people may either be forced to invest in higher risk assets and may incur losses, or they realise the risks and instead invest more conservatively, thus never earning sufficient amounts, by way of investment return, to reach the level of their full award.

1.2 Ministerial Powers to set discount rate

Section 24(1) of the Civil Liability and Courts Act 2004 gives the Minister for Justice and Equality the power to prescribe by regulation "*the discount rate that shall apply for the purposes of the assessment of damages in respect of future financial loss"*. To date the power has not been exercised by a Minister. Instead the rate has been set by the Courts.

1.3 Gill Russell vs. HSE

The discount rate was set at 3% in 2003 in the Boyne v Bus Átha Cliath case. However, in the period from about 2012 there was strong pressure to reduce the rate significantly because of the alleged lower returns being achieved on cash and bond investments.

This resulted in a Court of Appeal decision, following an earlier determination of the High Court, in the case of *Gill Russell v HSE* [2015] IECA 236 wherein the Court ruled for that case that the discount rate should be reduced to between 1 and 1.5% depending on the head of damage, and this has subsequently become the prevailing rate.

The impact of this judgment on the quantum of lump sum settlement awards is significant. In the *Russell* case alone, the effect of the application, actuarially, of the new rate was to increase the level of special damages by a factor of 38%. The State Claims Agency has estimated that the application of this level of a discount rate has increased the cost of meeting clinical negligence claims by approximately €100m per annum and it has had a similarly dramatic, inflationary effect on the calculation of the Clinical Indemnity Scheme's Incurred but not Reported (IBNR) liabilities. It is likely to have a similar effect on private insurers.

The essence of the decision can be summarised as follows:

1. The Plaintiff is entitled to have his damages calculated on the basis that he should be entitled to pursue the most risk averse investment reasonably available to meet his needs; he is not in the same position as the ordinary investor, who has income and has surplus funds to invest;

2. The court must consider the calculation of future financial loss on a 100% basis, regardless of the economic consequences that the award may have on the Defendant, on the insurance industry or on the public finances. Public policy has no part to play in the assessment of damages of this nature;

3. How the Plaintiff will probably invest, or how the Courts Service will probably invest on behalf of a minor/Ward of Court, is irrelevant to the Court's considerations;

4. There is more than sufficient evidence to support the findings of the High Court Judge that the 1.5% and 1% rates of return were appropriate.

In making its decision on this matter, the Court noted the existing Ministerial power, under section 24 of the 2004 Act, to prescribe the discount rate applicable in such cases. However, it also recognised its own jurisdiction to apply a rate different to that prescribed, if it is satisfied that an injustice would result from its application. Therefore, the likelihood is that if the Minister were to prescribe a rate materially different from this judgment, the courts may still use their discretion to pay what they consider the appropriate rate.

1.4 Key conclusion of judgement

In many respects, the key point of the above judgement is the view that the Plaintiff is entitled to have his damages calculated on the basis that he should be entitled to pursue the most risk averse investment reasonably available to meet his/her needs. The argument for this is that he/she is not in the same position as the ordinary investor, who has income and has surplus funds to invest. The court in taking this view that index linked gilts (ILGs) were the most effective way of providing certainty and removing risk to the plaintiff is heavily influenced by what was an equivalent UK position at the time of the judgement.in relation to how the discount rate should be calculated.

However, in the UK, a recent review of how the discount rate is calculated has led to a change in methodology. This has resulted in a decision that the discount rate should now be set by reference to expected rates of return on low risk diversified portfolio of investments, rather than very low risk investments. This is a significant policy change and has resulted in the discount rate moving from -0.75% to -0.25%.

1.5 Development of UK position and its relevance to Ireland

In order to understand the evolving UK position it is necessary to provide some context. Firstly, the trigger for the review was the decision by the Lord Chancellor acting in accordance with the law at the time (i.e. very low risk investment approach) to change the discount rate from 2.5% to -0.75% with effect from 20 March 2017.

The change in this rate led to renewed calls for a reconsideration of the way the rate is set. It was argued by some parties that the method at the time which derives from principles established in the 1998 House of Lords case Wells v Wells was flawed. The main criticism of this approach was that it overcompensates plaintiffs contrary to the overall objective of an award of damages that a person should get no more or no less than they are entitled to in order to cover their costs and loses.

The principles that underpin the UK approach to setting a discount rate prior to the review were as follows:

(i) The rate should be set at a rate which would enable the full compensation of a claimant – neither more nor less.

(ii) The rate should be sufficient to enable all expected losses to be met in full as they are expected to fall due without shortfall.

(iii) The rate should be set at a level such that the sum, whether by way of settlement or court award, along with the income assumed to be earned on the capital sum over the period of its investment, will be exhausted or substantially exhausted in line with the claimant's anticipated life expectancy.

(iv) The rate should be set on the basis that personal injury claimants are to be treated as very risk averse and will invest cautiously.

These principles resulted in the rate in the UK being determined by reference to the Index Linked Government Stock (ILGS). This approach effectively assumed that all claimants adopt a virtually risk free investment strategy, and by setting the discount rate at the lowest level possible, it minimises the risk that claimants will be undercompensated for their future losses. However, the issue, which generated controversy, is that where claimants adopt a different investment strategy, which has the potential to outperform the risk free rate, then they have the possibility to place themselves in a better situation financially compared with one where the basis for the claim had not arisen in the first place.

The reality is that, from a risk perspective, claimants have to counter the risk associated with concentration (all the eggs in one basket) with a more diverse investment strategy, even if this approach remains a fundamentally conservative one. A key question however is the balance in such a strategy.

Criticism in the UK to such an approach, which is also applicable in an Irish context, was as follows:

(i) To assume a very low risk investment approach in all cases will result in a significant cohort of claimants being overcompensated, because not all are as risk averse as the discount rate suggests

(ii) The assumption that claimants will only invest in ILGS is unrealistic and the rate should be set at the level that people actually invest or are advised to invest

(iii) Any system that produces a real negative rate, as is the case in the UK at the moment, is flawed as it would be irrational to pursue an investment strategy that provides absolute certainty of a loss.

To counterbalance these criticisms it was pointed out that from a theoretical perspective the purpose of the discount rate is to ensure the perfect level of compensation, i.e. not too much or too little. In reality, there will be different outcomes in different cases, resulting in some people being over compensated and others being under compensated. However, the ultimate purpose of setting the discount rate at a particular level is to protect vulnerable people taking account of a particular set of market conditions, which at this time happen to result in negative interest rates.

1.6 UK Review of discount rate

As a result of the reduction in the discount rate to -0.75% the UK carried out a consultation exercise on how the personal injury discount rate should be set in future.

As part of its review, the following issues were examined:

- What principles should guide how the rate is set?
- Are the present principles still fit for purpose?
- What should the principles be?
- What investment returns should be taken into account in setting the rate?
- Should the possibility of a periodical payment order affect the decision as to the relevant investments?
- How often should the rate be set?
- Should this be left open, as now, or would a set pattern of review be better?
- Should reviews be triggered by degrees of change in investment returns?
- Who should set the discount rate?
- Should the power remain with the Lord Chancellor or would it be better for someone else, possibly an expert panel to set the rate?

1.7 Outcome of UK review

The conclusions of the consultation process were as follows:

How the discount rate should be set

There were a range of different views expressed with plaintiffs and defendants adopting predictable positions, with the former favouring the existing very low risk level, while the latter supported a higher level, but still low risk. There was however general agreement that plaintiffs should be assumed to be more risk averse than ordinary prudent investors. The Report concludes that, based on the evidence presented and its analysis, that the assumptions made by the present law on the setting of the discount rate as to how claimants invest are unrealistic and that these rates may produce significantly larger awards than the required 100% compensation.

Who should set the discount rate?

There was support for introducing more independent expertise and transparency into the process for the setting of the rate while others argued for political control of the final decision albeit with advice from an independent panel.

Review of the discount rate

There was a broad consensus that reviews should occur more frequently than currently provided for and with greater predictability.

Civil Liability Act 2018

Following the consultation, the UK Government decided to make the following changes to the law:

(i) The discount rate should set by reference rates to expected rates of return on low risk diversified portfolio of investments, rather than very low risk investments as at present; and in assessing those rates the actual investment practices of claimants and the investments available to them should be considered.

(ii) The principles for setting the discount rate should be set in statute.

(iii) The rate should be reviewed promptly after the legislation comes into force, and thereafter, at least every three years.

(iv) The rate is to be set by the Lord Chancellor with advice from an independent expert panel.

(v) No changes proposed to the law relating to Periodic Payment Orders (PPOs) – PPOs are explained in Section 1.8.

These proposals were given legislative effect in the Civil Liability Act 2018 (UK). However as with Irish existing legislation, the new UK legislation allows courts to use a different rate of return, if it thinks it more appropriate in a particular case.

Review of Discount Rate – March 2019

Under the Civil Liability Act 2018, the Lord Chancellor was obliged to carry out a review of the discount rate within 90 days of the commencement of the provision. This review was started in March 2019 and completed in July 2019. Following the review, a new rate of -0.25% was brought into operation in relation to claims settled from 5 August 2019.

1.8 Periodic Payment Orders (PPO's)

The Irish Civil Liability (Amendment) Act 2017 was enacted in 2017 and came into full operation on 1 October 2018.

The measures in the Act stem from the recommendations of the report of the High Court Working Group on Medical Negligence and Periodic Payments (2011), chaired by Justice John Quirke. The Department of Justice and Equality undertook an intensive policy analysis and consultation process with the Department of Finance, the Department of Public Expenditure and Reform, the Department of Jobs, Enterprise and Innovation, the Department of Health, the Office of the Attorney General and the State Claims Agency in the development of the Bill. Representatives of the insurance sector and of the Personal Injuries Assessment Board were also consulted.

The primary purpose of the Act is to empower the courts to make awards of damages in cases of catastrophic injury by way of periodic payments orders. The Act addresses the concerns raised repeatedly by the courts about the absence of legislation to enable periodic payments orders in appropriate cases.

Briefly, the Act:

- grants courts the power to make awards of damages by way periodic payment orders (PPOs) in cases of catastrophic injury;

- provides that payments under periodic payment orders are secure and will last for the lifetime of the injured party;

- provides that payments will be indexed, initially, in line with the Irish Harmonised Index of Consumer Prices (HICP)[1] and provides for a review of the index after a five year period;

- makes provision for the treatment of periodic payments in bankruptcy; and

- makes provision for the treatment of periodic payments for income tax purposes.

The Act provides an additional option for claimants to consider in respect of how they are to be compensated, and in many instances the likely outcome will be a mixture of a lump sum and a periodic payment approach. However, there is a question mark as to how extensively they will be used, if discount rates are set at a level which makes the lump sum option more attractive.

It should be noted that a recent UK consultation paper on the issue of discount rates in relation to the use of PPOs states as follows:

> "*Claimants and defendants are thought to consider the choice between a PPO and a lump sum at an early stage of their negotiations and to varying degrees to keep the choice in mind as negotiations progress. Some will positively favour a PPO but some will not. Claimants may have personal reasons such*

[1] It is noted that, in a recent Directions Hearing concerning on the indexation provision in the PPO legislation, the High Court ruled that indexation of periodic payment orders using the HICP index provided for in the Civil Liability (Amendment) Act 2017 would not meet the cost of future care needs of catastrophically injured people. A review of the impact of the judgment has commenced.

as a desire to take control of the money and to make a clean break from the defendant. Defendants may wish to close off their liabilities. Both will be affected by the general economic climate.

The NHS Litigation Authority for example, has currently more than 50% of the total PPOs issued and generally obtains the claimant's agreement to a PPO when it wishes to do so. The costs of these awards are met from funds provided by contributions to the indemnity scheme by the NHS provider members, who are ultimately funded by taxation.

The other principal defendant using PPOs is the Motor Insurance Bureau (MIB). Every insurer underwriting compulsory motor insurance is obliged, by virtue of the Road Traffic Act 1988, to be a member of MIB and to contribute to its funding. Private sector providers of PPOs such as financial institutions, generally have to provide for future expenditure on PPOs in their accounts. This may have contributed to making PPOs less attractive to them than lump sum settlements overall"

In summary, therefore from a claimant's perspective there may be a variety of reasons as to why they will opt for a PPO or a lump sum. However, from a defendant's perspective, PPO's appear to be more attractive to the State or bodies such as a Motor Insurance Bureau rather than private insurers who seem to favour a lump sum approach.

In making a submission on how the discount rate is calculated, respondents are invited to consider the impact their preferred option may have on the general operation of Periodic Payment Orders in catastrophic injury cases.

Section 2: Consultation Questions

A series of questions are presented below, the answers to which will have an influence on how the discount rate is calculated going forward and as importantly the mechanism for doing so.

2.1 General Questions:

1. In determining the discount rate, should it be left to the Judiciary to decide on the appropriate rate on a case by case basis, or should the existing section 24 of the Civil Liability and Courts Act 2004 be amended by introducing principles and policies to allow the Minister for Justice and Equality to determine the rate and review at intervals thereafter? Please provide an explanation for your preference.

2. If you favour updating existing legislation, and introducing principles and policies, can you please provide a view on what you think the investment strategy underpinning the discount rate should be? Options include:

   (i) Maintaining the existing risk averse approach as set out in the Gill Russell V HSE case (low risk investments), or;

   (ii) Adopting the approach recently introduced in the UK of determining the rate by reference to expected rates of return on low risk diversified portfolio of investments.

3. Please outline any other options that you think would be feasible for calculating the discount rate explaining why you think these would be appropriate.

4. In setting out your favoured option can you please provide supporting evidence of how claimants actually invest their compensation and their reasons for doing so?

2.2 Legislation Questions

If you consider that the discount rate should be the subject of legislation please indicate:

1. Whether the Minister for Justice and Equality should retain the existing power under section 24 of the 2004 Act to set the discount rate.

2. If so, should a panel of experts be established to advise the Minister with regard to the setting of the discount rate?

3. In the alternative, should a panel of experts be established to set the discount rate?

4. What principles or policies would you like to see included in the amended legislation?

5. Should the principles and policies underpinning revised legislation assume the profile of the claimant to be:

    (i) very risk averse – as is currently the case;

    (ii) low risk – a mixed portfolio of balancing low risk investments – as in the UK;

    (iii) an ordinary prudent investor;

    (iv) another type of investor.

    Please give reasons for your response.

6. Should the courts retain the power to apply a different rate than the rate provided for in legislation?

7. Should the Minister (or expert panel) be empowered to set different rates for different classes of case?

8. How often should the discount rate be reviewed?

2.3 Periodic Payment Orders (PPO's) Questions

9. What impact would changes to the existing discount rate have on the use of periodic payment orders in catastrophic injury cases?

10. Has the decision in Gill Russell vs. HSE made it more or less likely that claimants will utilise PPOs?

2.4 Recent UK Developments Relevancy to Irish Market Questions

11. How relevant is the outcome of the UK consultation on the personal injury discount rate to the Irish market?

12. What weight should be given to UK experience as part of this review process?

Section 3: Consultation Process

3.1 Consultation Period

The consultation period will run until **5 August 2020**. Any submissions received after this date may not be considered.

3.2 How to Respond

Please make your submission in writing, preferably electronically as a word document or a pdf document by email, on or before **5 August 2020**. Submissions should be marked "Consultation on discount rate" and sent by email to **discountrateconsultation@justice.ie**

When addressing the questions raised in the Consultation Paper, please identify the question number you are referring to and clearly set out the basis for your views.

3.3 Freedom of Information

Please note that responses to this consultation are subject to the provisions to the Freedom of Information Acts.