MASS
MOTOR ACCIDENT
SOLICITORS SOCIETY

Ministry of Justice Consultation:

Setting the Personal Injury Discount Rate

Response from the Motor Accident Solicitors Society

January 2019

This response is prepared on behalf of the Motor Accident Solicitors Society (MASS) and submitted by the Chairman, Paul Nicholls.

MASS is a Society of solicitors acting for the victims of motor accidents, including those involving personal injury (PI) MASS has 110 solicitor firm Members, representing approximately 2000 claims handlers. We estimate that member firms conduct in the region of 400,000 PI motor accident claims annually on behalf of the victims of those accidents. The Society's membership is spread throughout the United Kingdom.

The objective of the Society is to promote the best interests of the motor accident victim. This is central, and core to our activity. We seek to promote only those policy and other objectives which are consistent with the best interests of the accident victim. We seek to set aside any self interest in promoting these arguments, recognising that we are in a position of trust, and best placed to observe the best interests of motor accident PI victims first hand. We are a not for profit organisation, which requires specialism in motor accident claimant work as a pre-requisite for membership. We also have a Code of Conduct which member firms are required to abide by, which is directed to the best interests of the motor accident victim.

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1. Broad observations

MASS strongly believes that the principle of the law of damages and what is best for the accident victim must remain the central focus for the Government when considering how the discount rate should be set in the future. No matter what their level of injury but especially those seriously injured, victims who have been injured through no fault of their own, must receive the care, attention and financial security that they are entitled to.

We continue to agree with Lord Hope's comments in *Wells v Wells* [1999] 1AC 345 that the principal purpose of the discount rate is to ensure that the 100% compensation principle prevails. To preserve, in so far as possible this principle, the discount rate should be set with regard to the best representation of a risk-free rate of return.

This is a very complex area where specialist advice is essential. We continue to be extremely concerned that the Government should not expect injured claimants, who by the very fact that they have claims for future losses are likely to be disabled, to carry the additional burden of seeking extra or in depth investment advice to ensure they have enough income on which to cater for their essential care needs and day to day living. It would be especially onerous for those with a brain injury which falls short of incapacity, those in severe pain, or those with communication difficulties or psychological injury such as PTSD. We believe that to impose such a burden on injured individuals would be fundamentally wrong and effectively amount to discrimination against the disabled.

Whilst appreciating the complexities surrounding setting the Discount Rate and the desire to create a defined set of principles on which to set the rate, MASS urges caution in generalisation and creating a 'rule of thumb'. By the very nature of these very complex and diverse claims, all claimants and their respective injuries are intensely 'individual' with their care, financial and long-term needs all varying considerably. We would urge constant consideration that the majority of claimants (and their families) would require all their time and effort in dealing/coping with their life changing injuries.

2. Questions

Please Note: MASS as an organisation is not in a position to provide statistical evidence, which is best supplied by relevant experts. We would, however, like to submit our general views and observations on the main principles that are being considered and have answered the questions where possible.

Investments available to investors

Q1: (a) What asset classes are generally available to claimants investing lump sum damages and suitable for the hypothetical "low-risk" investor envisaged in the setting of the discount rate?
(b) What asset classes are not generally available in practice to such an investor, for example due to reasons of scale, liquidity, cost-efficiency or unsuitability?

A1: (a) Qualified professional investment advisers will be best able to answer this question about asset classes, but generally, the full array of asset classes available to most private or corporate investors, including cash, bonds, equities, gilts, property and commodities, is available to claimants. The asset classes chosen would be tailored to the individual circumstances and are generally based upon the concept of low risk. A portfolio is likely to contain a mix of some or all of the asset classes available and would likely be appropriately proportionate to the risk profile associated with each asset class.

Due to the nature of the long term and complex injuries, it is vital that investment of compensation ensures that claimants have access to funds for their daily living requirements and costs as well as providing funding for their 'long term' care and living needs.

Consequently, the type of risk and how the compensation is invested will be affected by the accessibility of the funds. Naturally requiring access to the funds is likely to impact on the level of risk available.

A1: (b) A claimant is likely to rely upon the advice of a skilled professional adviser on the appropriate asset class investments for their circumstances in building a diversified portfolio. Many of the asset classes are unlikely to be readily available directly as investments to claimants (eg. gilts) but may form part of a portfolio through a trust or fund. Others, such as investment property or commodities, are unlikely to be suitable investment vehicles for inexperienced investors. The vast majority of claimants are unlikely to possess the investment expertise necessary to build and manage a diverse portfolio of investments.

Investment advice provided to claimants

Q2: (a) Please provide information regarding how recipients of lump sum damages awards for future financial loss are typically advised to invest, when they are normally advised and why?
(b) Is there any regulatory material or guidance available to those providing such advice? If so, what?
(c) Does such guidance help advisers achieve a suitable and consistent approach?
(d) Do claimants follow the advice given? If not, please explain to what extent and why.
(e) Is the cost of pre-settlement financial advice given to the claimant paid by the defendant as part of the settlement? What sums are involved?

Q3: (a) To what extent do changes to financial conditions affect investment advice provided to claimants who receive a lump sum award?
(b) Is there any evidence available to show how the change to the discount rate in March 2017 directly impacted upon investment advice provided to claimants?

A2: (a) Most claimants do not receive expert investment advice until settlement and are due to receive their award soon. Some solicitors advise their clients to seek preliminary investment advice ahead of settlement so that likely debts incurred during their court case can be resolved quickly upon payment and a sustainable long-term financial plan is put in place as soon as possible.

A2: (b) Investment advisers will be able to answer this with authority.

A2: (c) Investment advisers will be able to answer this with authority.

A2: (d) Each claimant is different with a particular set of circumstances and wishes, and will respond to financial advice differently, as do we all. We have no quantitative data, but the majority of claimants probably accept most or all of the financial advice they receive from their advisers. Inevitably some will make their own investment plans.

A2: (e) A claimant is not able to recover the costs and disbursements of pre-settlement financial advice.

A3: (a) Investment decisions are often impacted by the current investment climate, but given the long-term nature of the financial support for claimants, investment advisers would ordinarily advise on a mixed portfolio within pre-agreed risk parameters to mitigate immediate or near-term financial conditions (eg. a volatile equity market).

A3: (b) In broad terms, we believe that the risk profile of investments for claimants has been significantly lower since the change to the discount rate was announced in March 2017. We would refer you to the APIL submission for a more detailed response.

Investments made by claimants

Q4: (a) Please provide evidence of how recipients of lump sum damages awards actually invest, and why?
(b) What sources of balanced reliable data on investments actually made by claimants are available?

Q5: (a) What data is available regarding the profile of claimants of lump sum damages?
(b) How are claims of loss typically split between loss of earnings and care needs, for notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively?
(c) Is a period of 30 years a reasonable overall average projection period to consider when analysing long-term investment returns from such portfolios, or would an alternative period or a range of periods be more suitable, and if so, which and why?

Q6: What evidence is available to illustrate how the following characteristics affect investment behaviours in practice?
(a) Age and expected future lifetime (e.g. longevity risk)
(b) Size of lump sum
(c) Initial and ongoing funding requirements (e.g. care or accommodation costs)
(d) Existence and requirements of financial dependants (e.g. spouse, civil partner, children)
(e) Other protected characteristics under the Equality Act 2010 (race, sex, disability, sexual orientation, religion and belief, marriage and civil partnership, gender reassignment, pregnancy and maternity);
(f) Availability of PPOs or other sources of income.

A4: (a) We do not hold any relevant statistical information.

A4: (b) We do not hold any relevant statistical information and are not aware of any alternative source of data on investments that might be accessible within the limits of client confidentiality and data protection regulations.

A5: (a) We do not hold any relevant statistical information. However, given that road traffic accidents impact all demographic groups, it is reasonable to assume that the profile of those in receipt of lump sum damages will also be from all demographic groups. It is also logical to assume that those accident victims receiving the highest damages and the longest post-accident care will be those in younger age categories.

A5: (b) Given that each case has a unique set of circumstances and personal characteristics, any division of damages between loss of earnings and care needs will reflect these individual circumstances. Long-term care and related costs are likely to form a higher proportion of the higher amounts of damages.

A5: (c) In our experience, those serious injuries resulting from a road traffic accident result in long-term disability and often involve young adults. This therefore requires ‘long-term’ care needs and financial security. Whilst we are concerned that claimants with shorter periods of loss receive adequate financial investment advice, we believe that in most circumstances, 30 years is a reasonable average projection period, being sufficiently long in length to cope with short term detrimental economic and financial conditions.

A6: (a)-(f) We do not hold any relevant statistical information.

For the more complex injuries where significant awards of compensation are given, we believe that it should be left to the individuals, their lawyers and experts to ascertain what is the most appropriate methodology for them and their circumstances when considering how they obtain their award and in what form. It may also depend on their individual needs, be it accommodation / specific equipment / care needs / age / life expectancy and loss of earnings. Both lump sum awards and periodical payment orders (PPOs) will be suitable for various areas and individual circumstances and therefore the lawyers, experts and the individual victim should have the flexibility to choose which method is most suitable to meet their needs for the duration that is required.

Taxation

Q7: (a) What taxation rates typically apply to claimants on their investment returns, and how does the distribution of these vary across ranges of different claimants? (b) How is the effect of taxation taken into account in determining what investments to make? (c) What might typical average current tax rates be for notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively (and no other taxable income)?

A7: (a) The usual tax rates apply for all claimants, including income tax and capital gains.

A7: (b) As with any investment, financial advisers will advice on a tax-efficient investment portfolio maximising personal allowances and reliefs to enable the claimant to legally retain as much of their settlement as possible for their long-term care and support costs.

A7: (c) HM Treasury will be able to provide this information.

Inflation

Q8: What evidence is available regarding the average long-term rates of inflation which apply to costs typically experienced by claimants in aggregate, and how do these compare to each of RPI, CPI, CPIH and earnings inflation?

A8: We would refer you to the detailed comparison statistics provided by APIL.

Investment management costs

Q9: (a) What investment management costs would notional investors with lump sums of around £0.5m, £1.0m and £1.5m respectively pay in practice and how are these costs broken down into different areas? (b) To what extent would a "properly advised" investor need to incur all of these costs, for example in relation to active or passive investment of funds?

A9: (a) Investment management costs take several forms and, in a competitive market, can vary greatly between providers, including annual management charges, financial planning charges and administration charges. Solicitors generally advise claimants to use providers with transparent annual management charges to minimise the costs. We suggest that detailed information is solicited from a range of investment providers for a full comparison of costs.

Insofar as how experts are paid for, we understand that the rate will be set net of taxation, inflation and investment management costs. Given the assumption that claimants are properly advised on the investment of damages awarded, they will have to bare the cost of financial advice.

MASS is concerned that the cost of financial advice is borne by the claimant. It is important to recognise that investment management costs and financial advice costs are two distinctly different areas and must be regarded as such. Consequently, we believe that financial advice costs should also be included in the costs set net.

Claimants will invariably rely on experts to provide financial and investment advice, all of which needs to be paid for. On the principle of 100% compensation they should not be expected to fund such advice from their compensation.

It is important to factor in the role of the varying type of expertise that is required and how that will be funded. For example, the involvement of personal injury solicitors throughout the claim process and at times beyond settlement is extremely important. The guidance and assistance they provide, especially when selecting suitable experts (particularly financial and investment advice) is invaluable, and perhaps heightened further when the claimant lacks capacity. In our experience the claimant will trust their solicitor throughout the process and the recommendations they make. This is supported by the professional obligations of solicitors to always act in the best interests of their client.

Model investment portfolios

Q10: (a) Please outline your views on how well each of the notional investment portfolios (i), (ii) and (iii) set out above would match the criteria for the investment approach to be assumed under the Civil Liability Bill (as summarised in paragraph 18 of this call for evidence). (b) Please provide your views of an asset class distribution of a portfolio which would best meet those objectives (which may or may not be aligned with one of the notional portfolios (i), (ii) or (iii) listed above). Q11: Please outline your views on how the appropriateness of the portfolios outlined in Q10 would alter for claimants within a reasonable range of different characteristics under the following criteria (all other things being equal): (a) Age and expected future lifetime (b) Size of lump sum (c) Initial and ongoing care funding requirements.

A10: (a-b) We are not in a position to provide a detailed assessment of the notional investment portfolios. However, based solely on the concept of appropriate risk, we would suggest that investment portfolios with a low risk are generally the most appropriate for claimants who must make their investments last for a lifetime of care.

A11: (a-c) We would defer to the advice of financial experts to calculate the impact of these criteria upon the notional investment portfolios.

Other considerations

Q12: (a) Are there similarities between the ways that lump sums awarded in personal injury cases are invested and how individuals choose to invest other funds, for which data might be more readily available? (b) For example, would data regarding defined contribution pension investments be of relevance – both in the way that funds are invested prior to initial withdrawal, and how these funds are managed in retirement (for example through income drawdown)? (c) Would any other financial products be useful to consider, and if so, what data and information is available on investment decisions for such products which could be useful in this exercise to develop a proxy for how personal injury claimants might invest lump sums? Q13: Do you have any other data or evidence to provide that you consider to be relevant to this call for evidence? If so, please provide it and explain its relevance. Q14: Please provide evidence of how the setting of the discount rate under the new law will affect persons with protected characteristics.

A12: (a) Whilst there may be some similarities, the particular needs of claimants requiring long-term medical treatment, on-going care and therapy means that they will always have particular financial requirements from their investment portfolio. For instance, catastrophically injured claimants will need immediate and regular investment returns for the rest of their life, entailing a mix of both readily accessible funds and longer-term investments. This is clearly very different from an individual saving for their retirement who does not need to have access to their investments for perhaps decades.

A12: (b) Please refer to independent financial experts.

A12: (c) Please refer to independent financial experts.

A13: No.

A14: It is self-evident that those most affected by the discount rate are those who are disabled, the young and the old. Removing the risk-free assumption as the basis for full compensation will clearly have a negative impact upon these people with protected characteristics.