Discount Rate and Disability-adjusted Reduction Factors

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Future losses

Discount rate
• 10 facts and opinions
• inflation and the new PIDR
• when is 100% compensation less than 100%?

Reduction Factors
• application in Swift v Carpenter
• additional guidance notes and guidance planned for Ogden Eight
The new PIDR: correcting over-compensation or creating more under-compensation?

   • changes the method by which the PIDR is determined
   • removes the assumption that the claimant is entitled to invest without risk
   • claimant must invest in risk assets with the assumed return making a contribution to damages.
   • power grab by the Executive

2. Mechanics of setting the PIDR
   • Lord Chancellor is firmly in charge – decides on the level of risk
   • expert panel has advisory role on level of risk only after five years
   • new PIDR on or by August 6th
3. Factors for LC to consider in fixing the PIDR
• returns available, returns received, taxation and inflation
• investment management costs. How much is enough (0-1.5%)? Who will advise on this (not the expert panel)?

4. GAD’s MoJ PIDR Analysis (2017)
• over-compensation of 35% or 49% at a PIDR of -0.75%
• defined as extra return when claimants invest in ‘low’ risk as opposed to no risk
• but to gain the return claimant has to bear risk and risk is costly because the claimant is risk averse, especially on care costs. Not something for nothing
• it is a financial benefit in return for bearing a financial cost
• GAD’s portfolio does not comply with The Pension Regulator’s Guidance
Claimant’s position is like that of a mature pension scheme (*Wells v Wells*)

- Lord Chancellor is in the shoes of the professional trustee and GAD in the shoes of the scheme actuary
- Regulated by government in the form of the Pensions Regulator (TPR)
- Duty on the trustee is to invest in assets backing the scheme liabilities “in a way that’s appropriate to the nature, timing and duration of the expected future retirement benefits payable under your scheme.” (TPR) 2018 p. 52
- TPR example 11 mature scheme with a weak covenant is a close match. The scheme can’t support downside risks. Guidance: robust risk management meaning liability driven investments (LDI) and where scenario and sensitivity analysis is a MINIMUM REQUIREMENT.
- LDI = low risk, low return largely in corporate and government bonds. Much lower risk than any of the three MoJ/GAD portfolios.
5. Different rates for different classes of case (Section A1 (3))

Potential rate-changers

- earnings-based losses (earnings inflation > price inflation).
- claimant country of residence
- duration of award – lower PIDR for lower life expectancy

6. Inflation

- CPI (G) < RPI (G) < earnings (G)
  - wedge 1 = 0.9PP, wedge 2 = 1.5PP

7. GAD’s Technical Memorandum 2019

- wedge 1 + wedge 2 = real wage growth above CPI = 0.7PP (Table 5)

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8. Historical evidence for wedge 2

Source: Gregory Clark, 2019
Notes 1950=100
### 9. Macroeconomic forecasts

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<tr>
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<th>OBR average earnings*</th>
<th>BE average earnings*</th>
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*Source:* as for above  OBR (2018) Table 3.3 GAD (2017) Table C1, BE Quarterly inflation Report 2018 p 25

*Notes:* * long term forecast  + historical annualised average 1950-2017

### 10. The real risk free PIDR and the New PIDR

- Risk-free rate based on a three-year ILGS yield is -1.6%
- Equivalent to -0.7% on a CPI basis.
- Earning based losses (relative to CPI and based on the 2.3% GAD assumption) is -3.0%
- Earnings-based losses (relative to CPI and based on a 1.5% BE assumption) is -2.2%
- This is not 100% compensation on previous and commonly understood definition
- A higher PIDR, say 1%, is (100% - 3.2%) in year 1, 96.8% compensation. In year 2, 93.9%, in year 10, 73.0% and in year 20 53.3% etc.
Purpose of the Reduction Factors

• discount life expectancy to retirement age for employment risks (non-mortality/vicissitudes of life)
• evidence-based approach replaces *ad hoc Smith v Manchester* and *Blamire*
• evidence from Labour Force Survey data from late 1990s and early 2000s
• included in Ogden table sixth edition (2007)
• guidance to get the valuation of labour market risks in the right ball park. Narrow it down to something sensible
• broad bands so discretion is reasonable but need to stay within the limits of the ball park
Difficulties in application

- individual cases don’t always obviously fit the group descriptions and the court’s duty is to determine on the facts of the case
- disability is difficult to define and there is a single threshold which is difficult to determine. The legal threshold has changed over time. Case law has widened the definition.
- either or both parties normally seek an adjustment but do so without advice (costs)
- the statistical concepts are not straight forward. The RFs are multipliers so what appears to be a small change say 0.6 to 0.7 is actually much greater than a 10% reduction in work life expectancy or in damages
• 43 years old graduate
• crushing injuries to both lower limbs with below knee amputation to left leg and some rigidity in right ankle and foot
• top of the range, well-fitting prosthetics
• impairment/functional limitation – some mobility limitations, phantom limb pain and fatigue
• disability/activity limitation – work is affected by unpredictable and intrusive pain, and by the amputation itself. ADL such as lifting and carrying and working at ground level are restricted
• employed pre- and post-injury (80% contract post-injury)
Plans for Tables A to D in Ogden Eight

- guidance on approach to adjustment of suggested RFs in Tables A-D. What is meant by a ‘ready reckoner’ and what is a sensible adjustment?
- expand education categories from three to five – none, GCSE, A level, degree and higher degree
- guidance on application of tables A-D when injury precludes pre-injury qualification. Mobility-impaired mechanic (Mr Conner) and the brain-injured knowledge worker
- map for new GCSE scoring system (1-9).

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- guidance on defining the disability threshold in the context of Billett v MoD.
- reduction factors are based on 2.5% PIDR. Report 0% for use in PPOs