

WHAT NEXT FOR THE DISCOUNT RATE?

Birmingham Insurance Institute lecture, 4th October 2017

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What next for the discount rate?



This lecture will:

- ▶ examine the underlying reasons for the rate change and its impact on insurers, insureds and intermediaries
- ▶ explore claims strategies and policy limits in light of the new negative rate, and
- ▶ consider possible future approaches and provide an update on the Government consultation



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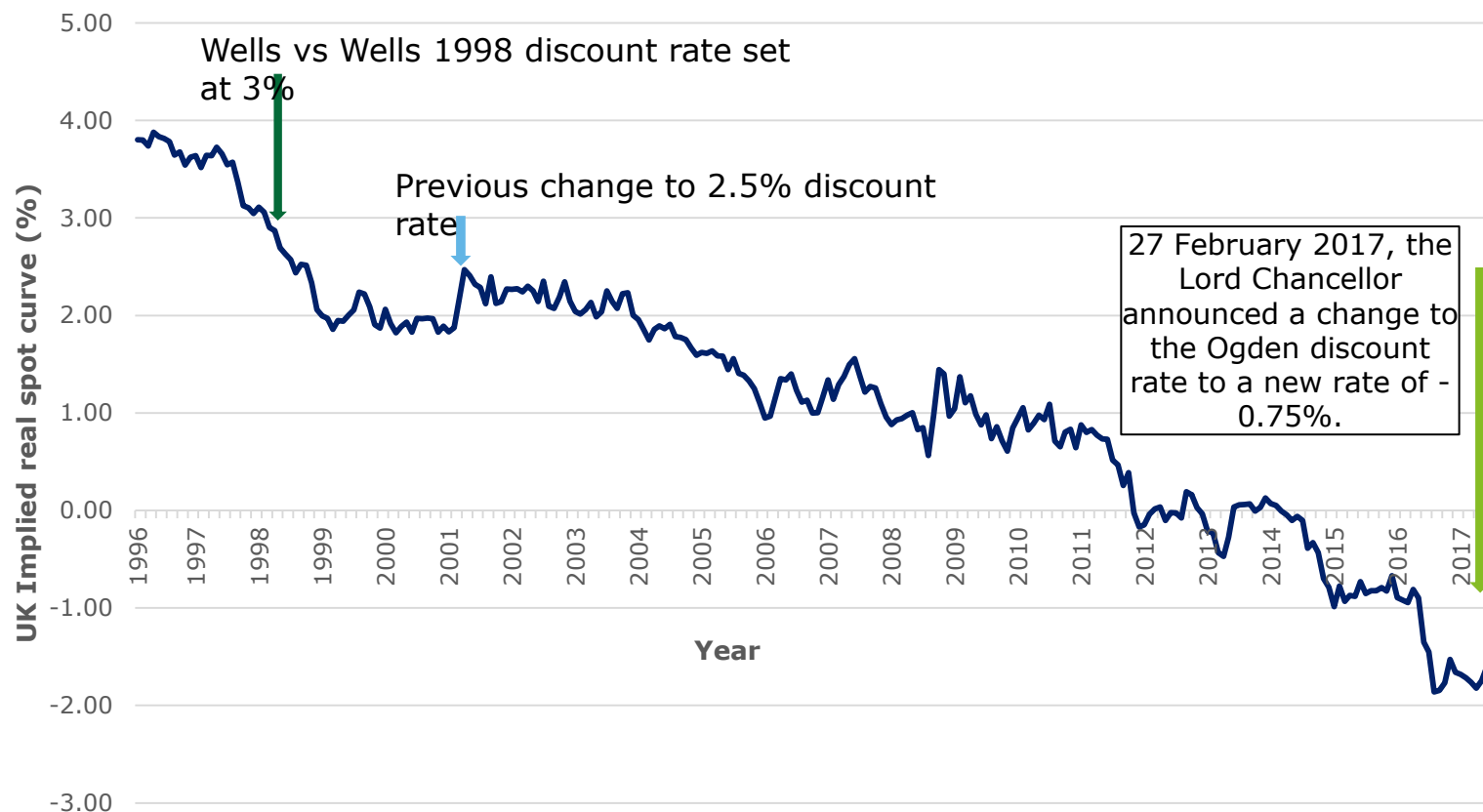
What next for the discount rate?



What happened?

Motor current profitability and benchmarking

Ogden - UK implied real spot rates (20 year term)



Source: Bank of England

Deloitte Motor Insurance Seminar September 2017

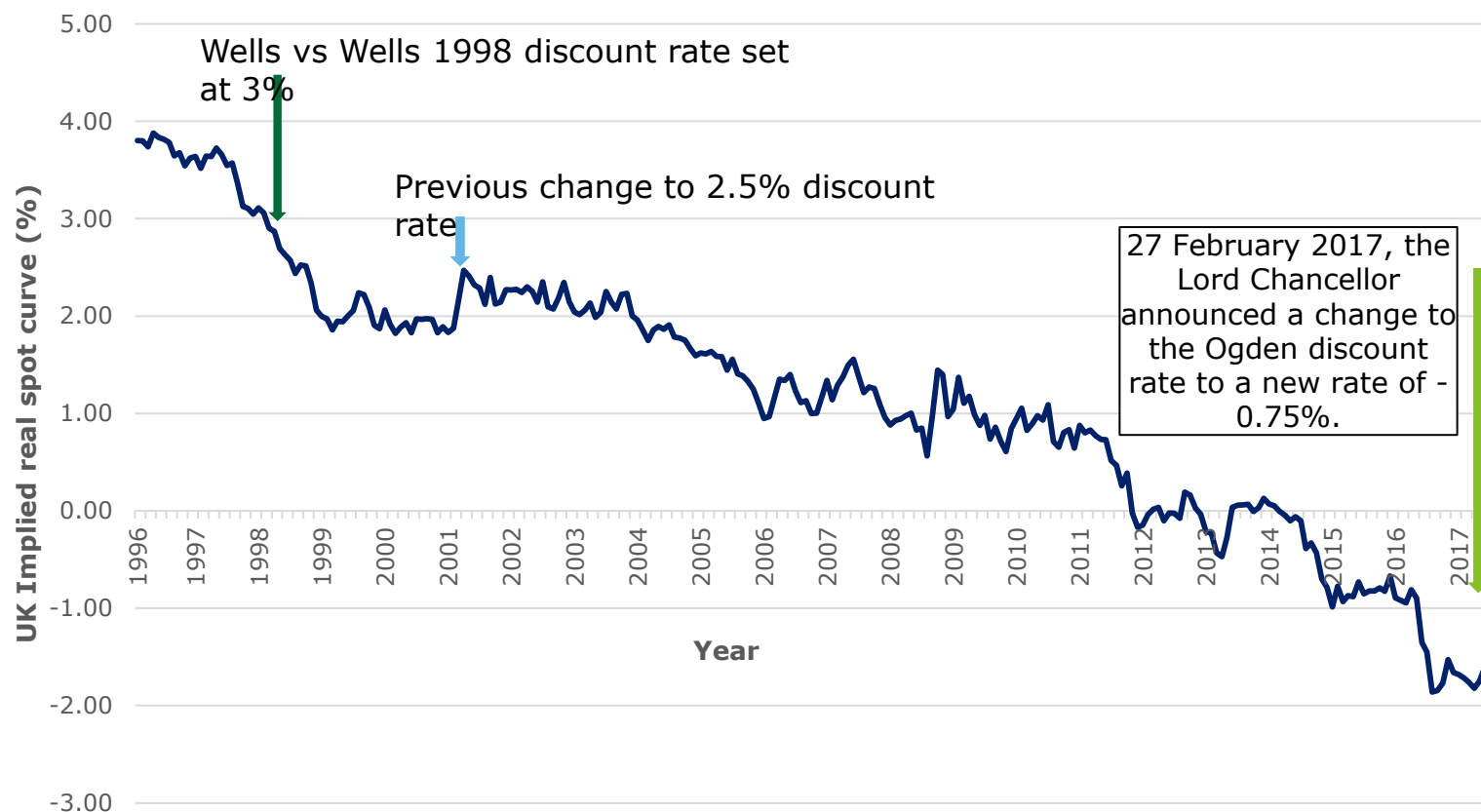
- ▶ key legal aspects are Damages Act 1996 and *Wells v Wells* (HL, 1998)
- ▶ the 1996 Act gives Lord Chancellor the power to set the discount rate
- ▶ *Wells* links the rate to the yield on Index-Linked Government Stock
- ▶ discount rate last set in 2001 at 2.5% (BoE base rate was 5.25%)
- ▶ ILGS yields have deteriorated since
- ▶ February 2017 rate goes to -0.25%:

"this is the only legally acceptable rate I can set"



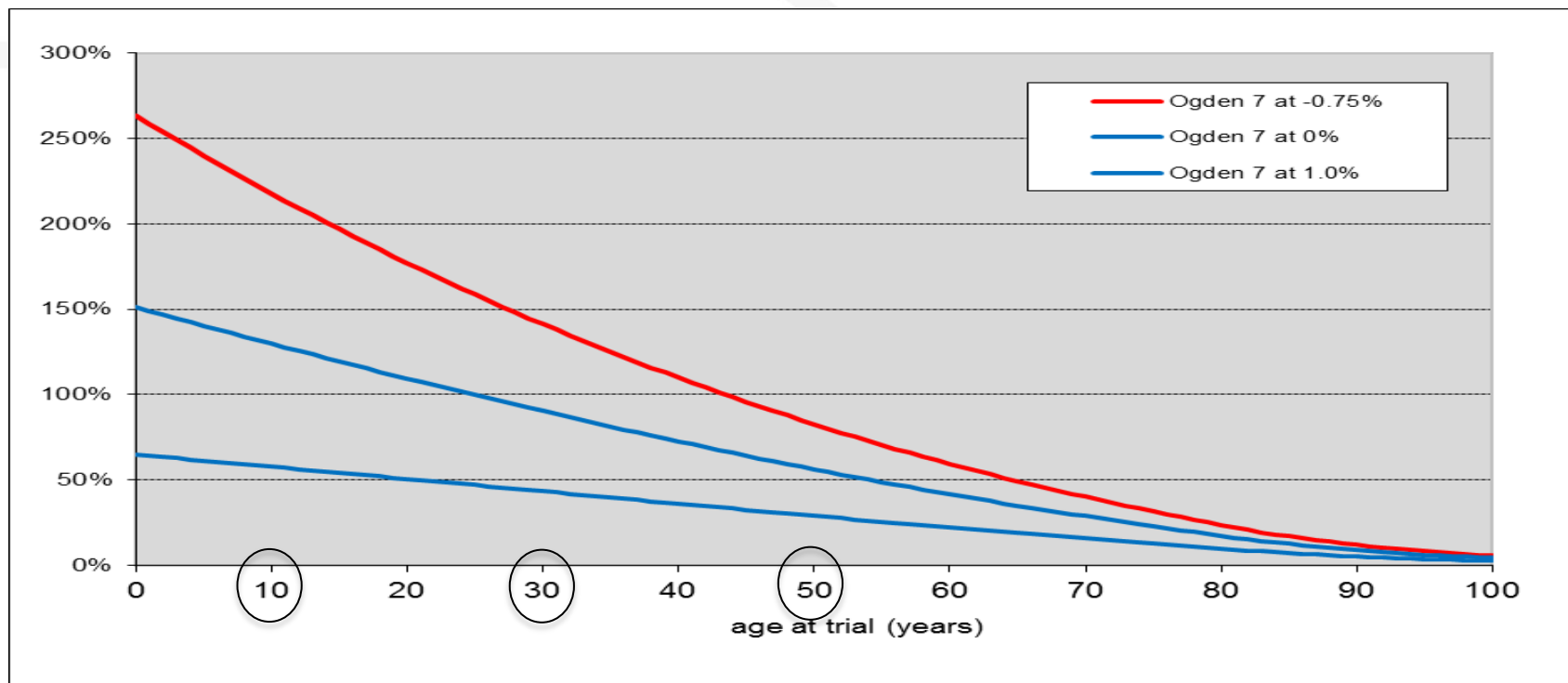
Motor current profitability and benchmarking

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age at trial	normal life expectancy (male)	then: Ogden tables at 2.5%	now: Ogden tables at -0.75%	percentage increase
10	78.31	34.08	108.32	218%
30	56.34	29.60	71.43	141%
50	35.45	22.69	41.44	83%

the future?	at 0%	at 1%
78.31	(130)	53.78 (58)
56.34	(90)	42.45 (43)
35.45	(56)	29.27 (29)

one theoretical case example...

	2.5% discount rate	-0.75% discount rate	% increases
claim value	£6m	£7.75m	29%
primary layer (£5m) pays	£5m	£5m	0%
XS / reinsurance (£5m XS 5m) pays	£1m	£2.75m	175%



gearing:
new awards at
-0.75% will eat into
higher layers &
reinsurance to a
greater extent

pricing:
cost of
reinsurance
protection likely
to increase ?

premium:
increased costs for
insurers, and
consequently
premium increases
(fleet & private
alike)

capacity:
possible
reduction in
market?

... and two real ones

Case / Injury type	Indemnity Limit	Class of business	Value @ 2.5	Value @ -0.75%
<p>Claimant aged 23 fell from a tree during the course of his employment.</p> <p>C5 complete spinal cord resulting in tetraplegia. He will require 24 hour care, case management and accommodation. Initial care costs in the INA are assessed at £296,165.</p>	£10,000,000	Employer liability	£8,970,000	£20,870,000
<p>Claimant aged 55 sustained a serious TBU following a fall down stairs.</p> <p>The claimant established liability at trial. The claimant Part 36 at £2 million which was accepted on the day of the DR change with an appeal outstanding on contributory negligence.</p> <p>There was no prospect of any recovery against the insured for damages over the policy limit.</p>	£2,000,000	Public liability	£1,100,000	£4,000,000

What next for the discount rate?



what is the potential for change?

- ▶ consultation March to May 2017
- ▶ expected outcome 3 August 2017
- ▶ election followed by Queen's Speech in June mentioning Civil Liability Bill

"to ensure there is a fair, transparent and proportionate system of compensation for damages to be paid to genuinely injured personal injury claimants"

"a mechanism that has grown outdated and, with negative returns on interest-linked gilts, lost its connection with the way people invest in the real world" (EST Stephen Barclay MP, 27 June 2017)

- ▶ **MoJ response & draft Bill on 7 September 2017**



Justice Update



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07 September 2017
Volume 628

Column 13WS

Share this contribution

The Lord Chancellor and Secretary of State for Justice (Mr David Lidington)

Earlier today, I notified the market via the London Stock Exchange Group that I would today lay a Command Paper “The Personal Injury Discount Rate How it should be set in future Draft Legislation” (Cm 9500) before Parliament.

The paper invites comments on draft legislation to give effect to the Government’s proposals to change the way in which the personal injury discount rate is set in England and Wales. If enacted, the proposals will lead to the rate being:

set by reference to expected rates of return on a low risk diversified portfolio of investments rather than very low risk investments as at present.

reviewed promptly after the legislation comes into force and, thereafter, at least every three years.

set by the Lord Chancellor following consultation with an expert panel (other than on the initial review which would be by the Lord Chancellor with advice from the Government Actuary) and, as at present, HM Treasury.

The proposals have been developed in the light of the responses to the consultation paper “The Personal Injury Discount Rate: How it should be set in future”, which was published on 30 March, and related research. It is not possible to predict accurately now what the rate will be when it is set under the proposals, as this will depend on decisions made in the light of the then current circumstances. Nonetheless, without restricting the future exercise of the proposed power, the Government might expect, based on the evidence currently available and using illustrative assumptions, that if a single rate were set today under the proposals the real rate might fall within the range of 0% to 1%.

I am also publishing today:

the Government’s response to the consultation;

an impact assessment in relation to the proposals prepared by the Ministry of Justice;

the Government Actuary’s Department’s report “Ministry of Justice Personal Injury Discount Rate Analysis” (dated 19 July 2017); and

the British Institute of International and Comparative Law “Briefing Note on the Discount Rate applying to Quantum in Personal Injury Cases: Comparative Perspectives” (dated 20 March 2017).

I will place copies of all these documents in the Libraries of both Houses and they will be available at:

<https://www.gov.uk/government/consultations/personal-injury-discount-rate-how-it-should-be-set-in-future> and

<https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/>.

Column 14WS

What next for the discount rate?

what does the timetable for reform look like?



- legislation needed = uncertainty
- minority Government = uncertainty
- Brexit timing (March 2019) = uncertainty
- by end 2018 or in h1 2019?
- prospective or retrospective?
- devolution aspects

What next for the discount rate?



consideration of policy limits in the market?


- ▶ claims once £1m to £2m now worth anything up to £5m
- ▶ the change in the discount rate has made £10m claims commonplace
- ▶ statutory minimum for EL cover in the UK remains £5m
- ▶ no statutory requirement or limit for PL & often low in SME market
 - ▶ insureds at greater risk of becoming insolvent?
 - ▶ can limits be increased?
 - ▶ claimants going uncompensated?
 - ▶ claimants pursuing greater numbers of defendants?



What next for the discount rate?



practical effects on settlements & case handling?

- 
- ▶ MoJ's window of 0% - 1%
 - ▶ part 36 offers
 - ▶ trials, JSMs & negotiations generally
 - ▶ likely timelines

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