RSA

UNDERSTANDING THE IMPACT OF OGDEN DISCOUNT RATE

AND GOVERNMENT'S RESPONSE TO THE OPEN CONSULTATION

OCTOBER 2017

THE OGDEN DISCOUNT RATE: WHAT IS IT?

The Ogden Discount Rate is used by our courts when calculating compensation in personal injury cases.

Compensation awards are designed to put the claimant in the same financial position had they not been injured. The award is based on future losses which are likely to consist mainly of loss of earnings and cost of care. Designed to ensure claimants are not under or over-compensated, the courts apply a calculation called the Discount Rate. This adjusts the personal injury damage award to take into account the return expected over time when a compensation lump sum is invested. Since the late '90s this rate had been set at a level to reflect the return available, on the lowest risk investments, typically index-linked gilts (the value of which has been falling since the financial crash in 2008). This rate had not been reviewed for 16 years.

THE OGDEN DISCOUNT RATE CHANGE: THE GOVERNMENT'S ANNOUNCEMENT

On Monday 27th February, it was announced by the Lord Chancellor that the Ogden discount rate would be reduced from 2.5% to -0.75% with effect from 20th March, setting a new rate applicable under the Damages Act 1996.

These changes are industry-wide. They impact claims costs across all lines of business that could be affected by claims for bodily injury such as: private and commercial Motor, Employers', Public/Products Liability and Package policies that incorporate Liability cover. With the exception of Guernsey (which already had a legal precedent for a lower discount rate) this applies to all UK jurisdictions.

PERSONAL INJURY DISCOUNT RATE: HOW SHOULD IT BE SET IN THE FUTURE?

On 30th March, the government launched an open consultation, as part of the review of the framework under which the personal injury discount rate is set. The paper considered possibilities for how, when and by whom the discount rate should be set.

The consultation closed on 11th May and the Ministry of Justice announced the conclusions of this to the stock market on 7th September.

WHAT ARE THE MAIN CONCLUSIONS?

- Acceptance that the assumptions under the current law as to how claimants invest are unrealistic and may produce larger awards
- The continuation of the use of one discount rate
- The rate will be reviewed at least every three years
- The review conducted by the Lord Chancellor will use an independent panel for advice
- The rate setting will use a portfolio of low risk investments rather than index linked government securities as a guide.

Within the government statement the following was included "Based on the evidence currently available, the government would expect that if a single rate were set today under this revised approach, the real rate might fall between 0 to 1%". It added: "The new framework will only apply if the proposed new law is enacted and will not operate retrospectively".

WHAT'S NEXT?

To enact this change parliamentary time is required and that is not likely to be available until Easter 2018 at the earliest and then any changes will not be effective for at least a further six months.

This does create a period of uncertainty until legislation is enacted but does provide clarity for the future in terms of process if the proposals are enacted. If the rate, when reviewed and set next year, falls in the range of 0 to 1% this still represents a step change in the level of awards in respect of future losses in personal injury claims compared to the pre February 2017 position.

HOW DOES IT INFLUENCE INSURANCE PREMIUMS?

THE IMPACT OF THE DISCOUNT RATE

AGE CATEGORY AND INJURY	2.5%	0%	0.5%	1%
Scenario A **Serious head injury** Male, 21 years old, life expectancy to 87. Requires 24-hour care.	£15,100,000	+60%	+40%	+26%
Scenario B **Paraplegic** Female, 31 years old, life expectancy reduced by accident to 80.	£5,200,000	+40%	+15%	+7.5%
Scenario C **Fractured hip, leg and wrist** Female, 57 years old. Retirement at 65 but not returning to work due to accident, small element of care.	£375,000	+17%	+14%	+10%
Scenario D **Neck, back and head injuries** Male, 29 years old. Retirement at 65, will return to work but reduced earnings capability.	£428,000	+16%	+12%	+8.5%

This will need to be reflected in pricing as limits of indemnity considered adequate for the lines of business affected, in particular: Motor, Employers', Public/Products Liability and Commercial Packages policies with Liability covers included.

RSA'S INITIAL VIEW ON PREMIUM

Our initial view is that premiums will need to increase by 7.5% to 10% on Motor and 4% to 5% on Liability to reflect this increased cost when compared to pre March 17 levels.

As we move through 2018 and the situation becomes clearer, including reinsurers, stance we will continue to review our pricing assumptions.

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THANK YOU