

ADVISER

CHANGES TO THE PERSONAL INJURY DISCOUNT RATE: A PRACTICAL GUIDE

The Lord Chancellor recently announced that the Personal Injury Discount Rate would be cut from 2.5% to minus 0.75% from 20 March 2017. We believe this will likely result in an increase in the cost of personal injury claims and a knock-on impact on insurance premiums in certain lines. In light of this, we recommend a series of practical steps you can take to manage the impact to your business.

Is this relevant to you?

If your business has potential for large personal injury claims then this is relevant to you. Questions you might therefore be asking include: Is this going to hit my bottom line? What are the implications on my policy deductible or aggregate limit? I have a captive with a loss reserve history – what affect will the changes have? How will my next renewal be affected? Read on to get our view.

How does this impact you?

The discount rate is used to calculate settlements for large personal injury claims when they include an element of future loss (see Case Study). An increase in the size of claims will either need to be funded directly by you, if self-insured, or by your insurer. Your insurer may then pass some of these costs back to you, by increasing premiums (specifically for motor, employer, public liability, and medical malpractice insurance). In either case, you are likely to pay more, but how much? And can you mitigate the impact?

Our calculations indicate the cost for such claims could increase by 1.5–3 times under the new regime.

What steps can you take?

There are three steps that we recommend you can take now to mitigate the impact of this change on your business:

1. Review your outstanding claims.
2. Improve your strategy for claims reduction and defensibility.
3. Optimise your renewal strategy.

1. REVIEW YOUR OUTSTANDING CLAIMS

First, review your outstanding claims to identify those that might be affected. We suggest banding your claims (for example, GBP250,000 – GBP500,000, GBP500,000 – GBP1 million, etc.), starting high and working down. Once the claims affected are identified, work with your broker or claims handler to quantify the impact of the rate change on your reserves for any self-insured component and the likely impact on your insurer's reserves for any losses above your deductible. If you have reserves on your balance sheet or through a captive, an actuarial re-valuation of the ultimate claim cost may be needed. For further balance sheet protection, you may also wish to explore solutions to introduce a cap on insurance liabilities.

2. IMPROVE YOUR STRATEGY FOR CLAIMS REDUCTION AND DEFENSIBILITY

Improving your claims strategy by finding ways to reduce both the frequency and the severity of claims is the most effective way to reduce these costs over the long term. To reduce the frequency of claims, you need to look at prevention; reviewing health and safety systems and procedures to reduce the risk of injuries occurring in the first place. To reduce the severity, you should look at your claims defensibility, that is, how to defend more civil claims and criminal prosecutions successfully with better evidence.

3. OPTIMISE YOUR RENEWAL STRATEGY

Once you have reviewed your outstanding claims and developed your strategy for reducing the impact of future losses, you will be in a better position to negotiate renewal terms with insurers. However, changes in insurer pricing as a result of the announcement may necessitate a review of your current insurance programme, including deductible and aggregate levels. Actuarial models can be used to quantify the likely impact to you in order to re-design a financially efficient insurance programme combining the optimal blend of your own and insurance market capital.

What to expect next?

The new discount rate may not remain at this level indefinitely. The Association of British Insurers, after being unsuccessful in forcing a judicial review, has pledged to appeal. Also, the Government has said¹ it will review the framework and provide a consultation before Easter, which will consider:

- Whether the discount rate should be set by an independent body in future.
- Whether more frequent reviews would improve predictability and certainty for all parties.
- Whether the methodology, which assumes that claimants only invest in index-linked gilts, is appropriate for the future, that is, are all claimants risk averse investors or do they invest in other investment vehicles where returns are far greater.

¹ 'The Rt Hon Elizabeth Truss MP change to personal injury discount rate', available at <https://www.gov.uk/government/speeches/justice-update>, accessed on 7 March 2017.

Case study: How does the discount rate work?

When an element of damages includes future loss, such as loss of earnings or future care, a discount rate is applied to reflect the fact that the claimant is receiving the money early in one lump sum, and will earn investment income.

For example, consider a 35-year-old male who is employed in a semi-manual job (deemed to be unskilled) and who has suffered life-changing injuries to the extent he will never work gainfully again. He is not disabled and he will only require a relatively modest care regime, all provided commercially, including any applicable case management costs.

His pre-accident earnings were modest. Loss of earnings (LOE) is based on GBP10,000 net per annum and he would have retired at age 65.

The base claim for damages for the future loss element on the current rate of 2.5% would be GBP200,000 for future LOE and the future care/case management would be GBP280,150. This gives a total of GBP480,750. By contrast, the new discount rate of -0.75% would result in a total of GBP955,000, an increase of GBP474,250, (nearly double).

| DISCOUNT RATE | CARE/CASE MANAGEMENT | FUTURE LOE | TOTAL |
|---------------|----------------------|--------------------|------------|
| 2.5% | GBP280,150 (28.15) | GBP200,600 (20.60) | GBP480,750 |
| -0.75% | GBP630,000 (63.00) | GBP325,000 (32.5) | GBP955,000 |

CONTACT

Marsh will continue to monitor the situation and issue periodic updates as necessary.

For further information, please contact your local Marsh representative.



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