MARSH

ADVISER

CHANGES TO THE PERSONAL INJURY DISCOUNT RATE: APRIL 2017 UPDATE

In March, we issued an Adviser explaining the changes to the personal injury discount rate (PIDR), a calculation used to determine lump sum compensation to claimants who have suffered life-changing injuries. There have now been further developments. This latest Adviser is designed to update you on these developments and explain in more detail the steps you can take to protect your position.

THE CURRENT POSITION

The PIDR change from 2.5% to minus 0.75% came into force on 20 March 2017. As it stands, this means the cost of large personal injury claims (those with an element of future loss of earnings and care costs) will go up significantly. However, it is important to note that the majority of claims are smaller, attritional losses and these are unaffected by this change. For example, Zurich Insurance states[1] that large and catastrophe losses typically represent 5% of net written premium for motor insurance, and 14% in respect of employers liability insurance.

BALANCING FACTORS

There are positive factors that will ameliorate (but not outweigh) the impact of the PIDR change: The Ministry of Justice legal costs reform, whiplash reforms, changes to the small claims court limits, and a reducing number of disease claims will all reduce claims costs.

GOVERNMENT CONSULTATION ANNOUNCED

On 30 March the Ministry of Justice[2] opened a consultation on the mechanism used to set the PIDR. The core issues examined in the consultation paper are:

- What principles should guide how the rate is set?
- How often should the rate be set?
- Who should set the discount rate?

The paper also considers whether sufficient use is being made of periodical payment orders as an alternative to lump sums.

The insurance market is hoping that the consultation will result in a more defendant-friendly discount rate. Indeed, the consultation impact assessment[3] states:

"A PIDR of minus 0.75% has been effective from 20th March 2017, set by reference to a three-year average of real gross redemption yields on index linked gilts (ILGS). There are, however, concerns that reference to such low risk investments may over-compensate some claimants (or, equivalently, lead to higher costs to defendants). There are also concerns that some parties may receive unfair outcomes if the rate is not set frequently enough to reflect prevailing economic conditions or that decisions concerning the rate are not informed by a suitable range of expertise in an open and transparent way. Government intervention is required to change the legal parameters used to set the PIDR."

While the consultation will only run until 11 May, it is important to note that any changes to the mechanisms that may be agreed as a result will require amendments to legislation or the passing of new legislation. Therefore, the impact of the current PIDR of minus 0.75% is likely to continue throughout 2017.

IMPACT ON INSURANCE RATES

Insurers – especially those with a book of business that has high exposure to large or catastrophic personal injury claims – are concerned about the change to the discount rate and the increased costs they will face as a result. Since the PIDR change was announced, we have seen some insurers, on specific cases, request an increase in rates. However, we are still operating in an insurance market with an abundance of capital, with insurers keen to obtain new business and to retain existing business.

In this environment we have – to date – generally been able to get the proposed increases removed. We are reminding insurers of the balancing factors mentioned earlier, which are reducing claims costs.

That said, over time, it is logical that insurers will have to find increased premium to pay for the increased claims cost they face. Catastrophe exposures also impact on the rates insurers pay for their reinsurance and therefore may put pressure on premium rates for impacted policyholders.

HOW TO PROTECT YOUR POSITION

If your business has – or has the potential for – large personal injury claims, we recommend the following steps:

1. ANALYSE YOUR CLAIMS EXPERIENCE EARLY

Review your outstanding claims to identify those that may be affected by the rate change. We suggest banding your claims together (for example, GBP150,000 – GBP250,000, 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. This will provide you and your broker with the detailed information needed to negotiate with the insurance market.

If you have significant levels of reserves on your balance sheet or through a captive, an actuarial revaluation 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. REVIEW YOUR CLAIMS AND RISK MANAGEMENT STRATEGY

Improving your claims strategy by finding ways to reduce both the frequency and the severity of claims is the most effective way to reduce the cost of claims 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. START RENEWAL DISCUSSIONS EARLY

If you have reviewed your existing book of claims and strengthened your claims strategy, you should already be in a better position for any renewal discussions. Work with your broker to discuss any proposed rate increases resulting from the discount rate, and create competitive tension between insurers where necessary.

If it is not possible to get the proposed increases reversed, you may wish to review the design of your insurance programme, including deductible and aggregate levels. Actuarial models can be used to quantify the likely impact to you in order to redesign a financially efficient insurance programme.

Review your limits of liability: the discount rate may push up the cost of some catastrophe claims (that is, those involving younger claimants which have a large element of future loss) by up to three times their current value. Consider whether any such future claims could breach the current limit you purchase and whether you should increase the amount of cover you buy.

HOW MARSH CAN HELP YOU

Our placement, claims, and client service teams are monitoring this issue closely and we will provide you with advice specific to your individual circumstances. Where necessary, we can undertake claims analysis projects and actuarial modelling to help you understand the impact on your business, provide the information you need to the insurance market, and work with you on safety management and claims defensibility.

CONTACT

Please contact your usual Marsh representative for assistance.

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[1] Zurich Insurance. Understanding Commercial Insurance Premiums 2017, available at: https://insider.zurich.co.uk/app/uploads/2017/03/Understanding-Commercial-Insurance-Premiums-2017.pdf

[2] Ministry of Justice. Personal injury discount rate: how it should be set in future, available at: https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate, accessed 3 April 2017.

[3] Ministry of Justice. "Discount rate impact assessment", available at: https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting_documents/discountrateimpactassessment.pdf, accessed 3 April 2017.

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