Motor insurance

M94/P94 2017–18 edition

Web update 1: 15 March 2017

Please note the following update to your copy of the 2017–18 edition of the **M94/P94** study text.

Chapter 5, section B1F, page 5/5

Please amend the paragraph beginning 'In the wake of' as shown (amendments in **bold** type):

In the wake of ongoing representations for changing the current Discount Rate (which has stood at 2.5% since 2001) the Ministry of Justice (MoJ) launched a consultation in February 2013. **On 27 February 2017, the Lord Chancellor and Secretary of State for Justice announced the outcome of this consultation. She has set the new discount rate at minus 0.75% and this comes into force on 20 March 2017 when the new rate will apply to all future loss settlements made on a lump sum basis after this date.** This is an important issue for motor and liability insurers, as a lowering of the Rate would result in higher lump sum awards, thereby increasing third party claims costs and placing pressure on premium rating levels. Conversely, raising it would have the opposite effect. **See chapter 7, section F8B, for more on the consequences of the raising of the rate.**

Chapter 7, section F2, pages 7/43–7/44

Please amend the text from the paragraph that begins 'The Ogden tables' as shown (amendments in **bold** type):

The Ogden tables (see section F8B) are used to calculate the correct multiplier (following the decision in *Wells v. Wells* (1999), and the correct 'discount rate' (to reflect the accelerated receipt of the loss), is determined by the Lord Chancellor, pursuant to s.1 of the Damages Act 1996. The rate **was made** 2.5% **in 2001**, being based on yields generated by index-linked government stock (ILGS).

However, **after** that decision was made, it **was** suggested that yields on ILGS have gradually declined and since 2008 it **has been** asserted that the average gross annual yield has been less than one per cent.

This has led to the Lord Chancellor and Secretary of State for Justice announcing a change to the Discount Rate from 2.5% to minus 0.75%, which comes into force on 20 March 2017. See section F8B for more on the consequences of this decision.

The issue regarding discount rates, and the review of the current rate, **was** brought into focus following the high profile case of *Helmot v. Simon* (2010) decided by the Guernsey Court of Appeal. The claimant, Manny Helmot was a 39 year old former Commonwealth Games cyclist who suffered extensive injuries, including the loss of the use of his right arm, rendered partially blind and suffered terrible brain injuries after he was knocked off his bike during a training ride in 1998.

Please delete the paragraph beginning 'There remains the possibility'.

Chapter 7, section F8B, page 7/48

Please delete this section and replace with:

The Ogden tables are an actuarial measure used to assess life expectancy and are designed to provide a guide for courts (and defendant insurers) in assessing damages awards for future losses in personal injury and fatal accident cases. They are prepared by a multi-disciplinary group of actuaries, lawyers and accountants together with representatives of the insurance industry. The tables provide factors known as multipliers which are used to assess present capital values of future annual losses or expenses.

There is also a 'discount rate', which has to be factored in, and this is the rate that courts allow for the investment of the lump sum of any compensation designed to produce income.

The Lord Chancellor is empowered to set the discount rate for courts to use under the terms of the Damages Act 1996 although there has been a tendency to leave such decisions to the courts. However, the Ogden actuarial tables tend to be regarded as the definitive guide for calculating multipliers.

The discount rate was set at 2.5% by the Lord Chancellor in 2001. On 27 February 2017, the Lord Chancellor announced that the discount rate would change to minus 0.75% from 20 March 2017 when the new rate will apply to all future loss settlements made on a lump sum basis after this date.

Immediate consequences
This issue is of particular interest to motor and liability insurers. The change in discount rate will inflate the cost of lump sum payments made to claimants by insurers. For example, a 21-year-old male with a serious brain injury and requiring ongoing medical care may have calculated his future losses at £8,242,086, applying a discount rate of 2.5%. However, the change in rate to minus 0.75% inflates the future care cost to £19,193,161 – an increase of over 120%.

Longer-term consequences
Motor insurers and most liability insurers will have reinsurance protection and the cost of this change is likely to be met primarily by the reinsurance industry, but in the longer term reinsurance premiums will rise and the cost of this increase will be passed down to policyholders. PricewaterhouseCoopers estimates the total reserve impact on the industry at about £7bn which translates to an increase in motor insurance premiums of about £75 a vehicle (although premiums for young drivers are expected to increase substantially and possibly as much as an additional £1,000 per annum). The change in discount rate means that insurers and reinsurers need to quickly reassess their reserves. This is likely to entail a thorough review of each claim file where third parties are claiming for future losses and applying the new discount rate, which will result in significant increases to reserves.