

# Personal Injuries Compensation

## What does the Discount Rate change mean for me?



## Discount Rate Change Factsheet

On Monday 27 February 2017 the Lord Chancellor, Liz Truss, made an important announcement in respect of the Discount Rate, which is used as part of the calculation to determine the amount of compensation to be paid to seriously injured individuals.

The significant change to the Discount Rate is one which affects the insurance industry as a whole, as well as you, the customer, and claimants.

This factsheet outlines what the recently announced amendments to the Discount Rate mean for you and how insurers are responding to those changes.

### What is the Discount Rate?

The Discount Rate, also known as the Ogden Rate, forms part of the calculation to determine the level of award in respect of cases involving serious injury.

Claim settlements for injury are made up of a number of key components:

- compensation for pain and suffering
- future loss of earnings
- future cost of care
- 'other' financial support, either towards activities that cannot be performed as a result of the injury (i.e. driving, caring for dependents etc.) or the provision of additional support, such as prosthetics.
- legal and professional fees.

When assessing future loss of earnings, the courts multiply the amount they consider the claimant will lose each year by factors such as their age and their projected mortality rate. Similar factors are applied to the amount required for future cost of care.

In the case of serious injury, the amount allocated towards loss of earnings and future cost of care can be high, as the settlement is designed to provide financial indemnity over a number of years.

When such an award is made in a lump sum, it can be therefore equate to a considerable amount of money.

As a result, an allowance is made by the courts in respect of future losses to reflect the fact that the claimant will be able to invest the lump sum awarded and earn interest on that investment over a period of time. The settlement is therefore 'discounted' by the amount of interest the claimant can expect to earn over that period. It is this adjustment which is known as the Discount Rate and that is subject to the recently announced changes.

The Discount Rate is linked to returns on low risk investments, typically Index-Linked Gilts.

### What has changed?

The Government has changed the Discount Rate from 2.5% to -0.75%. This means that, rather than any lump sum award being discounted to allow for a 2.5% investment return, the indemnity settlement will be increased, reflecting a decision that over the long term there is predicted to be a negative return on investment.

The effect of this change will be to increase the value of claims for future financial loss. The change is most significant for younger claimants, for whom the settlement needs to cover the greatest length of time.

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#### Why has the rate changed and when does it take effect?

The Discount Rate hadn't been adjusted since 2001, despite interest rates falling during that time. The yield on gilts and government bonds, particularly, has fallen during this time.

The recently announced reduction in the rate is designed to reflect the fact that less investment income is available today compared to when the rate was last adjusted, and has been introduced to ensure that claimants are more appropriately compensated over the remainder of their lives.

This will apply to all claims settled in England and Wales on or after the 20 March 2017 and Scotland on or after the 28 March 2017, regardless of when the loss was incurred or notified.

#### What does the change mean for me?

As mentioned above, the Ogden 'Discount' rate was set at a level to help ensure that when an injured person was paid today compensation for a loss of wages or for care that might be needed 30 or 40 years from now, the amount of that loss was discounted by an amount to allow for the interest they would earn before that money was actually needed. The concerns that inflation is higher than investment returns on 'Gilts' mean that instead of a discount, a small loading will instead apply. The difference between 2.5% and -0.75% doesn't sound that much but here's an example of how it could work in practice.

	+2.5% (Old Discount Rate)	-0.75% (New Discount Rate)
Compensation for care expenses for this year	£40,000	£40,000
Compensation for next year	£39,000	£40,300
Compensation for year 3	£38,025	£40,602
Compensation for year 30	£18,715	£50,051
Compensation for year 40	£14,529	£53,934
Total for the next 40 years	£963,926	£1,871,973

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#### Which lines of business / products are affected by the changes?

The Discount Rate applies to injury claims, so any product which provides cover for Motor (including Motor Trade) or Liability (Employers' Liability and Public & Products Liability) will be affected. This includes Property-led products such as Property Owners and Landlords where liability cover is included.

#### So, does the change mean my insurance premium will increase?

The heightened cost of claims for insurers will mean an increase in the cost of insurance, in respect of those products that are affected, regardless of where the insurance policy is bought from.

Insurers have to ensure that today's prices reflect the cost of claims in future years, which are now going to be significantly higher than they previously were. We will ensure however, that any increases will be kept in line with the wider market and that disruption to you will be kept to a minimum.

#### How much will my insurance premium go up by?

The percentage change will differ depending on your individual circumstances, including the activities you undertake, your claims history and your exposure to severe injury losses.

#### I've never had a claim. Does this mean I won't be affected?

Large losses are much more difficult to predict than small to medium ones. Previous claims history isn't always an indicator of your likelihood to incur a significant claim in the future. Unfortunately, unpredictable accidents happen in all industries including those which are perceived as low risk.

Exposure within liability or motor lines of business will inherently carry a risk of incurring a liability for a claim involving a serious injury and therefore premiums need to reflect a proportionate allocation for potential large losses in the future. In this way, insurance acts as a pool, whereby an amount of premium is secured from everyone to create a fund to pay for the larger losses which statistically will occur from the relative few in the pool.

The exact amount of this will depend on a range of factors, including trade activities, approach to risk management, previous claims history and exposure to serious injury claims. But if the cost of large losses increases, then so must the contribution that everyone makes to the pool. That includes low risk and claims-free cases.

#### Questions?

If you have any further questions about what the Ogden Discount Rate change means for you, please get in touch with us.