Subject: Consultation on the discount rate to be used in calculating bodily injury claims settlements

Presenters	APPG	Others
Peter Walmsley: Partner, Insurance & Reinsurance, Clyde & Co Dr John Pollock: Pollock & Galbraith Doug Hall: Head of Forensic Services, Smith & Williamson	Jonathan Evans MP Heather Wheeler MP Lord Hunt Lord Blencathra	David Worsfold Paul Clarke (PwC) Others – an attendees' list was circulated by the Group's secretary (attached)

On the morning of the meeting The Department of Justice launched the latest consultation concerning its review of the legal framework surrounding the calculation of damages for bodily injury claims. This in particular focussed on how the discount rate which is used in the calculation of lump sum settlements should be determined.

The current discount rate of 2.5% has not changed since 2001 notwithstanding significant reductions since then in Index Linked Gilt yields from which the 2.5% was originally derived.

The key issue is whether the discount rate should be set by reference to the yield on Index Linked Gilts or a more mixed portfolio of assets which might include higher yielding but higher risk equities and corporate bonds.

As an alternative to lump sum settlements, in some situations claimants might instead receive periodic payments for life in the form of an annuity.

Note of key matters:

1 Presentation by Peter Walmsley, Clyde & Co.

Key highlights:

- The discount rate is a significant component of the calculation of lump sum damages in personal injury claims and has a significant impact on insurance and reinsurance pricing
- The various reviews of how the discount rate should be determined were creating uncertainty in the market, magnified by ongoing uncertainty about the new Solvency II capital rules
- In 2001 the Lord Chancellor had concluded that bodily injury claimants were not ordinary investors and hence the discount rate should not make any assumptions about how the funds might be invested
- In a recent case in Guernsey (which was not covered by the Damages Act) it had been concluded that a discount rate of minus 1.5% was appropriate

- As an illustration, a reduction in the discount rate from 2.5% to 1.5% on a £150m portfolio of liabilities would increase the cost by £20m. A reduction to minus 1.5% would increase the liability by £155m

- It was inherently wrong to base the discount rate on an investment strategy which was rarely followed in practice

- Approximately one third of large bodily injury claims are now settled through the periodic payment route which was based on a separate calculation linked to care worker salary inflation.

2 Presentation by Dr John Pollock; Pollock & Galbraith

- Because in recent times claimants had not been able to invest lump sums in Index Linked Gilts at 2.5% yield, full recompense for loss was not being achieved

- Higher returns could only be achieved at the expense of security and risk

- Insurance premiums would go up modestly if the discount rate went down. Dr Pollock estimated that a reduction in the discount rate from 2.5% to 1% would result in a 6% increase in premiums

- A significant proportion of high value claims are from younger drivers because of the longer life expectancy over which care could be required.

3 Presentation by Doug Hall; Smith & Williamson

- There was little statistical information about how damages had been invested in practice.

- Smith & Williamson frequently advised low risk investors to hold balanced portfolios including equities and bonds in addition to Index Linked Gilts, however, based on the experience of the previous few years of depressed prices, portfolios with significant equity elements had struggled to yield more than 2.5%

- Volatility in prices was only an issue when assets were sold which was not necessarily an issue for long term investors

- Periodic Payment settlement had many advantages in avoiding the investment dilemma.

4 Q & A

It was noted that the discount rate was also relevant to the settlement of personal injury cases in the public sector (notably in the NHS) and that therefore the issue also had an impact on the public purse.

It was noted that although premiums as a whole might increase modestly in the event of a reduction in the discount rate, it was possible that there would be marked increases in premiums for young drivers where the lump sum costs were higher and where frequency of accident was also higher. High premiums for young drivers was already an issue.

The Group reflected on the respective merits of lump sum and periodic payment settlement methods.

Paul Clarke
19 February 2013