Personal Injuries Compensation AXA's Response to Discount Rate Changes

Q&A Guide for Brokers – March 2017

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About this Guide

On Monday 27 February the Lord Chancellor, Liz Truss, made an important announcement in respect of the Discount Rate, which is used to calculate 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 its customers and claimants. In this document, we outline what the recently announced amendments to the Discount Rate mean for you and your clients and how we are responding to those changes.

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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 etc.
- 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 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.

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What has changed?

The Discount Rate has changed 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. To give an example, the award made to a 27 year old female with a serious life-changing injury will move from £6.5m under the old Discount Rate to approximately £14m under the new one.

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 significantly 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 20 March 2017, regardless of when the loss was incurred or notified.

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What is the impact of this change?

The precise impact will vary from claim to claim but, in principle, the more severe the injury and the longer the period of time that earnings are lost and care is required, the greater the impact of this change on the settlement amount.

By way of illustration, some examples are given.

The overall cost for the insurance industry across all current claims that are impacted is estimated to be £7bn.

The estimated ongoing annual cost thereafter for the insurance industry is around £1.2bn per annum.

It follows that large claims, over £100k and particularly over £1m, are the ones affected by this change, where future losses form a significant component of the overall claim reserve.

Example claimant	Settlement before	Settlement after
30 year old plasterer with a traumatic brain injury	£2.24m	£6.14m
18 year old male claimant with spinal cord injury	£7.6m	£19.3m
55 year old male who sustained a below joint amputation.	£1.4m	£2.05m

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What is AXA's stance on the recent changes?

It is our strong belief that injured people should receive adequate compensation for the injury they have sustained.

We aren't in control of the rate that has been set by the Government, but we are fully committed to ensuring that our response remains responsible and considers the needs of our policyholders as well as any current and future claimants.

AXA is a well diversified and financially strong business, so there should be no concern from claimants or policyholders in our ability to meet claims under the new regulations.

As one of the world's largest insurers, our strong levels of solvency mean we are able to withstand the initial impact of the Discount Rate changes.

We remain absolutely committed to the motor and liability markets in the UK, today and in the long term.

What action is AXA taking?

The overall cost of the Discount Rate changes is significant and impossible to absorb on an ongoing basis. As a result, it is necessary for us to take action.

Claims	Pricing
We will be reviewing the estimates on outstanding motor and liability claims that are impacted and adjust them accordingly. This will lead to some significant estimate increases on some outstanding case reserves. Decisions on liability remain unaffected. We will complete this exercise by the end of April. You can access current estimate reserves and claims details on eServe.	The substantial increase in claims costs affects multiple lines of business which attract claims for bodily injury, including Motor, Public/Products Liability and Employers' Liability whether traded through a branch or on our Connect eTrade platform. Given the scale of this change, we will be applying price increases. The impact of pricing amendments will depend on a range of factors, including the activities undertaken by the insured, their claims history and their exposure to severe injury losses. Our teams remain committed to working with you to manage the implementation of the pricing changes that are required.

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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.

What impact will the Discount Rate changes have on my client?

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

As a leading motor and liability insurer, AXA will obviously be affected by the change and there will be a rise in premiums for new and existing customers. We, however, continue to be committed to the motor and liability insurance market in the UK and any price increases will be aimed at ensuring we can continue with this commitment for the long term.

Why does a 3.25% movement in the Discount Rate generate such a significant increase in claims reserves?

It reflects on the cumulative cost of a typical annual payment that would be taken from a lump sum, which previously could be discounted each year because of an assumed investment return, but now in effect is loaded because of an assumed investment loss. That is why claims relating to younger injured persons are the most severely impacted by the change. If a claimant needs to be financially compensated for a long time, the compound effect of the new Discount Rate is significant.

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Why is my client experiencing a price increase?

The substantial increase in claims costs affects multiple lines of business which attract claims for bodily injury, including Motor, Motor Trade, Casualty and Construction, whether traded through our branches or electronically via our Connect platform. Given the scale of the impact of this change, it is simply too significant to absorb.

We 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.

How much will my client's rates go up by?

The percentage change will differ depending on the individual client's circumstances, including the activities undertaken by the insured, their claims history and their exposure to severe injury losses.

Our teams remain committed to working with you to manage the implementation of the changes that are required.

My client has never had a claim / is in a low risk industry. Why are price increases being applied to them?

Large losses are much more difficult to predict than attritional ones, and previous claims history isn't always an indicator of a client's likelihood to incur a significant claim in the future. Unfortunately, accidents happen, often quite unpredictably. Equally, large liability and motor losses can be incurred within industries which are perceived to be low hazard, albeit the likelihood of this may be lower than in other industries.

Clients who have an exposure within liability or motor lines of business inherently carry a risk of incurring a liability for a claim involving 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 will depend on a range of factors, including their 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. This applies to all policyholders, whether low or high risk and whether claims free or not.

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I have a client with a large injury loss on the go. What will this mean for them?

The main immediate change that you are likely to notice is a reserve movement on that claim to reflect the new cost of settlement. There will be no other change to the process of handling or settling that claim.

As previously highlighted, price increases are generally needed to fund the cost of these changes and any revised claims costs will form part of the process of deciding the insurance cost for the client moving forward.

Are you still honouring the terms of long term deals that are currently in place?

We recognise the importance of long term deals to your clients, whether they be rate stability agreements or LTAs. We also understand the certainty they provide by setting out a consistent approach to rating for the period of the deal.

Our deal wordings do make provision for the unusual circumstance where a significant change in an external factor materially affects the risk of loss, the scope of cover or the premium rates applicable. The change in the discount rate falls within the category of a significant legislative change which materially affects pricing.

In consideration of the value you and your clients place on these arrangements, we remain committed to standing by as many of the existing deals we have in place as possible and to continuing to offer these as part of our proposition going forward. In the event that we need to take action on a specific case that is currently under a deal, our teams will work closely with you to agree next steps.

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What is AXA's position in respect of renewal terms and / or new business quotes that have already been issued? Will we stand by them or should they be rescinded in light of the Ogden changes?

In most cases, we will stand by the terms we have issued. If the Ogden impact on an individual risk is particularly significant, perhaps because of the large loss experience on the particular risk, then consideration will be given to rescinding terms and re-negotiating.

What will be the impact on Scheme / Delegated Authority business?

Where we have agreed to a delegated underwriting authority, your relevant AXA contact will be in touch soon to discuss what changes are required to respond to the move in the Discount Rate.

If you have any additional questions, get in touch with your local AXA branch contact.

Thank you