

# Cost of UK insurance could be hit by Government ruling



The cost of some insurance in England and Wales could increase, following recently announced changes to the discount rate.

The discount rate applies to lump-sum compensation payments awarded to personal injury or fatal accident claimants for future losses. The compensation is reduced by the value of the discount rate, which is the assumed rate of return on investing the lump-sum. The higher the rate, the lower the initial lump sum needs to be, and vice versa.

The decision to reduce the discount rate is likely to increase costs for insurers, who might then pass on some of these costs to UK policyholders.

Employers' liability, motor insurance (personal and commercial) and healthcare are most likely to be affected, because these include a high proportion of long-term injury claims.

## What happened

The discount rate had been set at 2.5% since 2001. However, on 27 February Lord Chancellor Elizabeth Truss announced that the discount rate would be reduced to -0.75%. The new rate will come into effect on 20 March 2017. This significant reduction could increase costs for insurers and companies with higher self-insured retentions in two ways:

1. reserves for past claims that have not yet been paid might have to rise, and
2. the cost of future claims will also rise.

The Association of British Insurers (ABI) called the reduction in discount rates a "crazy decision". The personal injury lawyers' trade group, however, said it was "long overdue". The Ministry of Justice said it had no choice under the current law.

## Impact on insurance

It is unclear exactly how much the cost of some insurance might be affected by this change, or when. And any change in the cost of insurance may not be solely the result of this discount rate reduction. However, various estimates have been made on the likely impact, including:

- The Association of British Insurers (ABI) estimated that up to 36 million individual and business motor insurance policies could be affected.
- The ABI also estimated the total cost to insurers in increased liabilities could be as much as £7bn – equivalent to twice the cost of the 2007 floods.
- PwC has predicted that the cost of an average comprehensive motor insurance policy will rise by up to £75, with higher increases for younger drivers and older drivers.
- Admiral estimated the change in discount rate could cost them as much as £175m, while Direct Line said it would reduce profits by up to £230m. (Both motor insurers saw their shares drop sharply following the announcement.)
- Where negligence claims are made against the NHS, the bill could rise by £1bn, said the Treasury. However, the NHS Litigation Authority will be compensated for any extra cost, said the government.

The Chancellor of the Exchequer, Philip Hammond, will meet with insurance industry representatives to assess the impact of the rate change. There will be a consultation before Easter to consider options for reform.

Lockton will provide a full analysis of this issue and its likely impact once its full significance becomes clear. We will also update you on material developments as they occur. If you would like further advice in the meantime, please contact your Lockton representative.

## The discount rate cut – in practice

The indicative example, across, is based on a claimant being issued with a £50,000 per year future loss. As shown, if the pay-out was to cover several decades (ie, for a young claimant), the difference in the lump-sum compensation would amount to several million.

