OGDEN DISCOUNT RATE FORUM
STAPLE INN TUESDAY 7 FEBRUARY 2017

A forum was held at Staple Inn, 7 February 2017, to discuss the current status, next steps, and actuarial and industry implications of the Lord Chancellor's review of the Ogden discount rate. Panel participants included:

- David Fisher (AXA)
- Mohammad Khan (PwC)
- Ben Priestley (KPMG)
- Chair: Martin Noble (Deputy Chair, IFoA GI Practice Board)

The following is a list of aspects presented and discussed during the Forum. The Forum itself was conducted under 'Chatham House' rules, with the exception that we would produce an unattributed list of topics discussed. This is not intended to be a complete transcript of the Forum. While we have intended to capture a full and accurate list of comments, this document should not be considered as such, in the situation that certain aspects of the discussion have inadvertently been omitted from this summary or have been captured incorrectly.

The comments listed below should not be viewed as the IFoA's view, opinion or consideration of potential impacts. The comments listed below are only a reflection of the topics and viewpoints raised.

For ease of reading, we have segmented the aspects into categories.

Thank you for everyone who participated, for a frank and open discussion.

1. Background

- The Lord Chancellor (LC) has overall control of the Ogden Discount Rate (ODR), though in consultation with HM Treasury and Government Actuary's Department.
- It is quasi-judicial power.
- Wells vs. Wells: this was the equivalent of a Supreme Court legal case underlying the current decision to set the ODR of 2.5%, whereby the ODR was set with reference to guidelines established in-line with *Wells vs Wells*, i.e. with reference to a three-year average yield of Index Linked Gilts (ILGS).
- A 3% ODR was in-force until 2001 (until 2002 in Scotland), when the then Lord Chancellor prescribed a 2.5% ODR. This ODR has been in place since that time. A consultation was conducted in 2012/2013, however no change to the ODR was effected as a result of the consultation.
- The current Lord Chancellor has stated she will complete her review of the ODR, with the results of the review now expected in February 2017.

2. **Next steps: considerations of the ODR review**
    - **It is important to note that while comments below were discussed in the Forum, the outcome of the ODR review is not known. Comments below that state a specific potential outcome of the ODR are conjecture and are scenario-based. The current ODR is 2.5% and it is possible for the outcome of the ODR review to result in a rate ranging from (say – again, this is conjecture) from +3% to -2%. Also note that the impact of a change in the ODR is not linear in-line with a proportionate change in the ODR; as the ODR reduces, the financial impact increases to a greater proportional degree.**
    - Possible outcomes of the LC ODR review:
        - Apply standard methodology and set ODR by reference to ILGS
        - Legislate to overturn Wells vs. Wells and reset statutory methodology
        - Set two discount rates – different rates for earnings related heads of damage and a lower rate for other heads of damage
        - Possibly have variable discount rate over time
        - Allow flexibility as whether new ODR will apply only to new cases or to all existing cases
    - There are perhaps two options:
        - Wells vs. Wells is not considered appropriate, hence impose a change to reflect reality, and hence apply a different approach to investments which would be less onerous than a ILGS-driven approach to determine the ODR.
        - Wells vs. Wells is still considered appropriate, which takes us towards negative discount rates.
    - It is difficult to see how a change in the ODR would not apply to current (unsettled) claims, as opposed to future reported or future claim incidents only.
    - The discount rate in Scotland, while set independently to the Lord Chancellor, may choose to follow suit with the result of the review, although this is not a required outcome.
    - Most international equivalents remain in positive discount rate territory.
    - It is unlikely politicians want to see significant capital pressure on the insurance industry (provides needed cover for Joe Public and is a source of tax revenue) – thus maybe 1% or 1.5% is more realistic for new ODR.
    - Government also would (presumably) like to see the benefits of whiplash reforms to be passed on to Joe public; severe ODR changes would jeopardise this.
    - Insurance market expectation appears to be a c.1% drop – but is this just the voice of optimism? If the *Wells* methodology is applied, the rate should be negative.
    - Is it right that claimant should expect a higher rate of discount (e.g. ILGS) than an insurer can achieve on its investments?
    - Investing in other than ILGS is necessary to achieve the needed yield, to cover inflation.
    - Roberts & Johnstone (R&J) – vehicle by which alternative accommodation costs are calculated, based on difference in capital values between the two properties (original dwelling and the new required abode) and multipliers applied.
    - Alternative to R&J: Rent both properties? What if representatives of “wrongdoer” is forced to buy the property in which claimant would live tax-free? What happens to properties on death of claimant?

- We need to remember that when a decision on the ODR is made, it is not final but reviewable in the future.

3. **Potential impacts of a change in the ODR:**
   - The financial impact could be significant, depending on the outcome of the review (clearly more negative ODRs would drive a more significant impact).
   - Would we expect a class action to follow change in ODR (e.g. to review previously settled cases)? No, if claimant is represented at original hearing, matters are unlikely to be overturned.
   - Areas of potential impact, from the perspective of an actuary:
     - Reserving
     - Capital modelling
     - Underwriting (particular impacts on certain underwriting segments)
     - Other areas (incl. Actuarial Function Report, ongoing business plans, IFRS 17 and move to best estimate reporting)
   - From a capital perspective, it is difficult to think about what might be a 1 in 200 year event. And what does 1-in-200 mean if the Ogden rate moves significantly (e.g. could this be a favourable movement, if the rate is set at in extreme negative territory?).
   - The Actuarial Function Report will be crucial, along with the opinions expressed therein.
   - Practical impact of changing ODRs into the future – e.g. impact on reserving triangles; would these need to be re-stated?
   - PPO propensity: this will likely reduce if the ODR reduces.
   - Other impacts of ODR changes on pricing and reinsurance renewals.

4. **Financial reporting, Solvency reporting and disclosure**
   - Determination of the booked reserve needs to reflect upon whether the Ogden rate review is deemed a post-balance sheet adjusting event.
   - Reserve sign-off – is there a margin around ODR change built in to the booked reserve?
   - Management may need a view or estimate of what will happen with ODR – e.g. a reasonable best estimate.
   - Actuaries and Management may need to disclose key assumptions and sensitivity therein, alongside presentation of the financial statements.
   - Key issues are governance, documentation, disclosure and sensitivity.
   - Due governance needs to be applied (NEDs have a role to play here).
   - Solvency II: if new reserves exceed the year-end risk margin, this may be a source of questions.
   - Investment analysts may ask questions about the level of provisioning.
   - Wording for uncertainty in reserves is crucial – but could accounts be qualified?
   - Disclosure: Firms declaring PPO and ODR exposure need uniformity. Who (which body – e.g. FRC) should provide guidance?
   - It might be helpful to have some comment about uncertainty in SAOs before announcement, e.g. disclose what you are doing and the sensitivity around it.

5. **Social, economic and public interest aspects**
    - Need to keep interests of claimant first – there are tax and investment fee implications: e.g. PPO is tax-free, as is lump sum. But once lump sum is converted to income, the latter is taxable and subject to investment fees.
    - As a profession we need to consider all aspects, and in particular consider the public interest.
    - Claim settlement: process in court can have an adversarial impact (i.e. lump sum vs. PPO settlement) – is this appropriate? Are the courts simply storing up problems for future generations? A fairer method of compensation might be to provide funds based on ongoing needs rather than as an indexed PPO. Should the profession support this, in the public interest?
    - What if segments of the population are priced out of the market by the rising cost of PPOs e.g. the oldest drivers? Would/should the Government then support these classes of drivers?
    - Paying claim damages based on needs removes claimant choice.

6. **Other aspects / comments:**
    - Lloyd's of London is to issue separate guidance.
    - Was the potential change in ODR on the risk register or otherwise well-known to Management?
    - The Forum has helped to harness opinions. It has encouraged proactive discussion. Are there other step changes that should be on our radar?

Notes prepared on behalf of the GI Board