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The Particular Problems with Periodical Payments

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Agenda

- Background
- Recent court judgements
- Indices
- Claimant and defendant preferences
- Trends
- Making allowance in pricing and reserving
- Funding periodical payments
- Reinsurance
- Questions and discussion

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In the beginning …

- Periodical payments (aka structured settlements) have been around since 1989
- Required agreement from both parties
- Claimants tend to prefer lump sums
- So, periodical payments tended not to be used much

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And then there was 1 April 2005

- Courts Act 2003
- Allows Periodical Payment Orders (PPOs) to be imposed by the court
- Even if the claimant and/or defendant do not want them
- "These proposals aim to promote the widespread use of periodical payments"

Baroness Scotland

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Courts Act 2003

- Court required to consider a PPO
- Can make a PPO without the consent of the parties
- Considerations of the court
- PPOs for dependants
- Awards can be indexed
- Variation orders
- Continuity of payment must be "reasonably secure"

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Imposition of PPOs

- Godbald v Mahmood
  - Neither party wanted it
- Sarwar v Ali & MIB
  - Claimant changed mind
- Burton v Kingsbury
  - Defendant wanted it

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But sometimes PPOs are not appropriate

Overseas

- A v Powys Local Health Board
  - Claimant in Ireland, no appropriate index
- Mealing v Chelsea & Westminster NHS Trust
  - Is there an appropriate index in France?

Contributory negligence

- Joel Reynolds v Buckingham Hospital
  - not 100% damages
- Rowe v Dolman
  - Not 100% damages appeal on life expectancy

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Other matters

- Harcourt v Griffin
  - Disclosure to reveal extent of defendant's insurance cover
- Thacker v Steeples
  - MIB reasonably secure
- Nunns v Cannon Crane & Plant Hire
  - defendant refused PPO, claimant purchased structured settlement with part of lump sum
- Pitcher v Headstart Nursery Limited, Caroline Gooding, Mayday NHS Hospital Trust
  - restriction on interim payment in order to allow PPO

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Why use a different index to RPI?

- Care costs are mainly wages
- Historically wage inflation has been greater than price inflation
- RPI less appropriate than an earnings index for a head of claim measured by wages

Differentials

AEI* manual females v RPI

Decade	1950s	1960s	1970s	1980s	1990s
Differential	1.79%	1.51%	4.54%	1.56%	1.31%

*Average Earnings Index

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What index should be used? (1)

Sarwar judgement:

"*It seems to me one of the great advantages of the new system is the flexibility which allows the court to adopt solutions appropriate to the facts of each particular case"*

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What index should be used? (2)

- RPI?
- Annual Survey of Hours and Earnings (ASHE)?
  - Care assistants?
  - Nurses?
  - Nursing auxiliaries?
  - Physiotherapists?
  - Psychologists?
- Use more than one?

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Indices used in recent judgements

▪ Thompstone	- care package	ASHE 6115
▪ Corbett	- care package	ASHE 6115
▪ Sarwar	- care package	ASHE 6115
	- loss of earnings	ASHE 90
▪ RH	- care package	ASHE 6115
	- therapy, holidays, transport, household expenditure, accommodation	RPI

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Claimant preferences

- Claimants usually prefer lump sums
- ££££££££££££££££££££££

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Advantages of PPOs for claimants

- Increased damages
- No investment risk
- No mortality risk
- Reduced inflation risk
- Income for life
  - claimant may waste lump sum
  - provides assurance to parents that child will receive regular income in later years

Some claimants will prefer PPOs

- Long life expectancy
- Uncertain life expectancy
- Young with catastrophic injury
- Child
- High ongoing care costs
- Complete or partial earnings loss

PPOs more attractive now?

- Use of indices other than RPI
- Credit crunch

Insurers usually prefer lump sums

- Certainty
- Don't take investment risk
- Don't take mortality risk
- Don't take inflation risk
- No ongoing administration
- Avoids reinsurance problems

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When do defendants want PPOs?

- Claimants life expectancy is uncertain
- For PR purposes
- When they think they can win on the investment return

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NHSLA - Periodical payments

	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Number	49	66	305	410	471	548	659
Value (£m)	117	192	590	525	663	901	1,373
Average	2.4	2.9	1.9	1.3	1.4	1.6	2.1

Source – NHSLA annual reports

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The need to allow for periodical payments

- PPOs have become more common over recent years …
- … and the trend is likely to continue
- Becoming increasingly important to adjust premiums charged and reserves held to reflect their impact
- Failure to do so could result in premiums being too low or reserves being understated

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Types of claims that may give rise to PPOs

- Catastrophic injuries to children
- Catastrophic injuries to adults
- Fatalities with dependents
- More minor injury claims

Factors affecting the likelihood of a PPO

- Expectation of life curtailment
- Uncertainty of life expectancy
- Magnitude of ongoing care costs
- Complete or partial earnings loss
- Contributory negligence
- Overseas resident
- Economic environment

Segmenting claim (1)

Catastrophic injury claims

- Young claimants with no significant expectation of life curtailment
- Young claimants with significant increase in uncertainty of life expectancy
- Other young claimants
- Older claimants or those with less than, say, 10 or 15 years life expectancy
- Other claimants with no significant expectation of life curtailment
- Other claimants with significant increase in uncertainty of life expectancy
- The rest

Segmenting claims (2)

Fatalities
- With dependants
- Without dependants

Remainder of claims
- Ongoing care with small earnings loss
- Partial earnings loss
- Future losses only
- The rest

Estimating the likelihood of claims giving rise to PPOs

- Likelihood will vary by segment
- Relatively little evidence so estimates will need to be somewhat judgemental
- Consider past experience …
- … but not that much of it …
- … and need to reflect increasing trend
- Seek input from claims and underwriting departments

How much should a claim be reserved for? (1)

Will depend on:
- the initial level of payments (A)
- the index or indices used (value of i_x at time x)
- the period over which payments will be made (t) where this could be until the death of the claimant
- the probability of the claimant surviving to each age (p_x)

How much should a claim be reserved for? (2)

- Then, if rate used to discount values back to the current time is d% per annum, the value of the claim is:

$$\sum^{t}_{x=1} (A * (i_x / i_1) * p_x) / (1 + d)^x$$

- However A, i_x and p_x can all be difficult to determine

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Estimating initial level of payment (A)

- Consider the costs that the payments are intended to meet, eg
  - current care costs
  - annual earnings prior to incident
- Also, consider past experience
- Currently, relatively little data available but this situation will improve over time

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Selecting appropriate indices (i_x)

- Logical to use different indices for different heads of damage, eg
  - for care costs, wage inflation for nurses or care assistants
  - for loss of earnings, wage inflation for appropriate profession
- Simplicity v precision
- Precision = complexity

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Selecting an appropriate life table (p_x)

- If life expectancy has not been impaired, should be straight forward
- If life expectancy is curtailed
  - use an appropriate impaired life table, if available
  - if not, need to judgementally adjust the most appropriate life table that is available

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Calculating the cost of claims

- Some claims will be settled as PPOs, others as lump sums
- Estimate likelihood of a claim giving rise to a PPO
- Reserve will be a blend of
  - likelihood of settling as a PPO x cost of PPO
  - *plus* likelihood of lump sum x cost of lump sum
  - summed over all claims
  - *plus* allowance for IBNR

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Does size matter?

- Could go through the detailed calculation for each claim that could give rise to PPO
- Most insurers will rely on average assumptions
- Small to medium size insurers could calculate the figures individually for catastrophic claims and rely on averages for other claims
- Larger insurers are likely to have to rely on average assumptions for all segments

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Funding periodical payments

- Two options:
  - buy an annuity
  - self fund
- In either case, need to allow for additional expenses

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Buying an annuity

- Is an appropriate annuity available?
- Can buy annuities linked to RPI
- But what if a PPO is made linked to eg, ASHE?
  - no annuities linked to ASHE are available
  - buy an RPI-linked annuity plus a flat rate annuity to top up
  - win in some years, lose in others
  - still partially self-funding
- Is the cost of the annuity prohibitive?

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Self funding

- Will become quasi "life company"
  - does the insurer have the appropriate expertise?
- Will require different investment strategy
- Need to establish systems to administer the process
- Regular proof of claimant's existence
- Could be costly to administer, particularly if relatively few PPOs

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Reinsurance

- Does the reinsurance programme enable an insurer to enter into periodical payments?
- If so, is it clear how the reinsurance will respond to periodical payments?
  - vital to clarify and agree this BEFORE any PPOs are made
- Indexation clauses introduce complications

Questions and discussion

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