



**The Actuarial Profession**

making financial sense of the future

# 34TH ANNUAL GIRO CONVENTION

CELTIC MANOR RESORT, NEWPORT, WALES

C02: Periodical Payments, Ogden 6 and the Impact on UK Insurers

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# Periodical Payments and Ogden 6

- Background
- Up-to-date position – periodical payments
  - Approach of the market to periodical payments
  - Real yields
  - RPI inflation or earnings inflation?
- Impaired life annuities
- Ogden 6
- Potential impact on UK insurance and reinsurance companies

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# Position before Courts Act (1)

Victims who have future loss as a result of a wrongful injury are entitled to:

- That sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation

Livingstone v Rawyards Coal Company (1880)

## Position before Courts Act (2)

- Usually a lump sum award
- Occasionally a periodical payment (or structured settlement) if this was the wish of **both** parties
- Lump sum awards are calculated typically for a number of separate heads of damage

# Heads of damage

- General damages (pain and suffering)
  - Past care
  - Past loss of earnings
  - Medical expenses
  - Other miscellaneous expenses
  - Future cost of care
  - Future loss of earnings
  - Pension
  - Legal costs
- } Ogden tables

# Ogden tables

- Actuarial tables available to the courts
- Calculates multiplier for future cost of care, loss of earnings and pensions, based on alternative real yields (nominal yield less inflation)
- Lord Chancellor's Department has prescribed a real yield of 2.5% per annum, net of tax

# Ogden 6 multiplier – 2.5% real yield

Male aged	Future cost of care	Future loss of earnings (65)	Future loss of pension
20	31.63	26.56	5.06
30	29.05	22.78	6.27
40	25.79	18.01	7.78
50	21.86	12.06	9.80
60	17.30	4.59	12.72



# Disadvantages of lump sum awards

- Based on average mortality
- Possibility of over-compensation or under-compensation
- Not tailored to pattern of financial needs of victim
- Investment of large sums of money

# Courts Act 2003

- The Court may order periodical payments instead of a lump sum for future pecuniary loss **without** the consent of the parties
- When considering whether to order periodical payments, the Court shall have regard to all of the circumstances of the case and in particular the form of award which best meets the claimant's needs
- Retrospective legislation
- Implemented on 1 April 2005
- Periodical payments may be linked to RPI
- Provisions to increase/decrease or “vary” periodical payments in specified circumstances

# Do periodical payments meet the needs of claimants?

Yes, to an extent, but it could be argued that:

- Reductions to allow for contributory negligence defeat the object of periodical payments
- RPI indexation is insufficient
- Variation provisions are inflexible
- There are security issues
- Some claimants may prefer to invest a lump sum
- There are issues surrounding the needs of dependants
- Claimants may not wish to continue to deal with the defendant's insurers

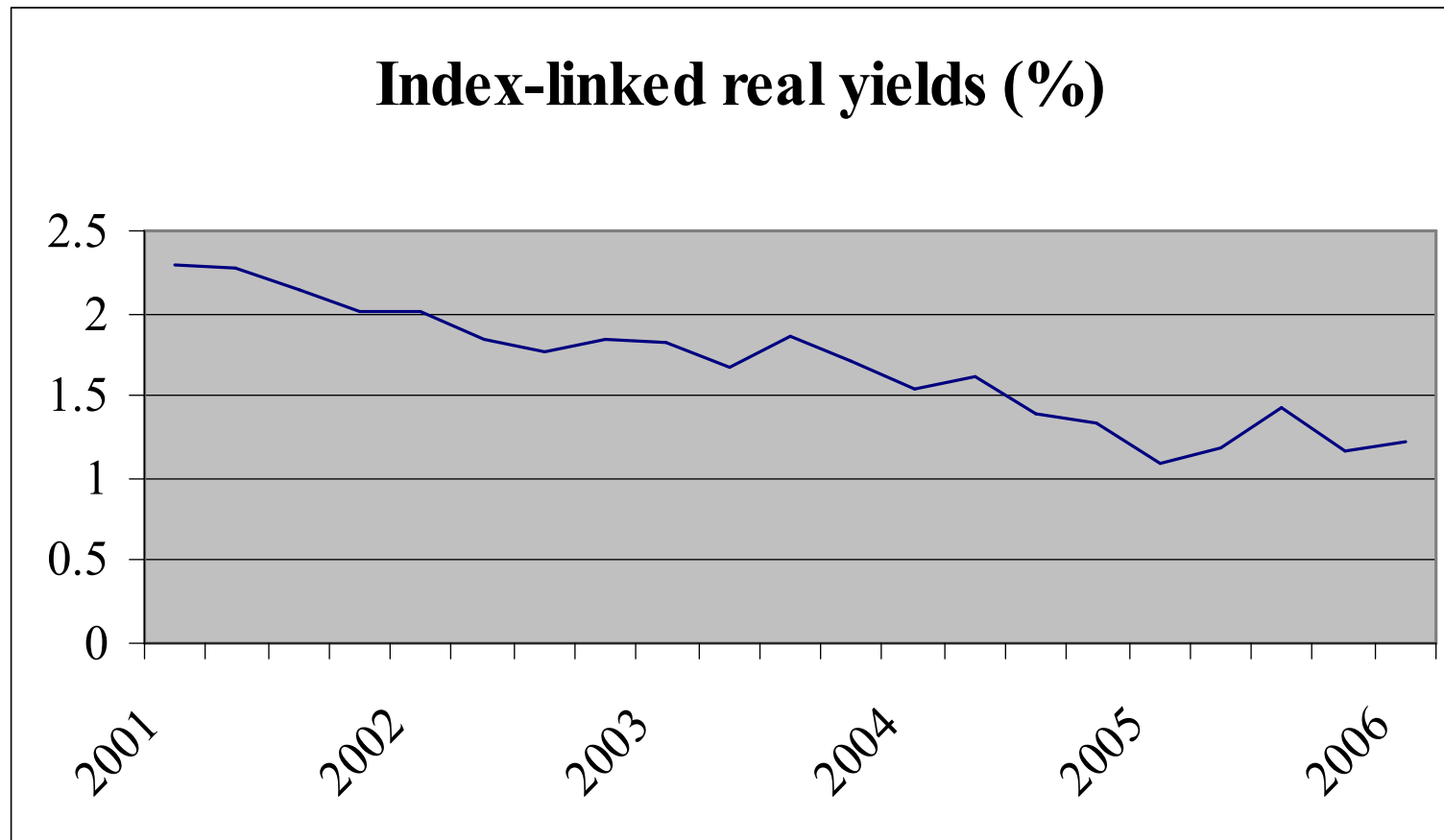
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# Approach of the market to periodical payments

- Insurers and claimants
- MIB

# Gross real yields



# Real yields (gross of tax) – Friday 28 September 2007

	Inflation 0% %	Inflation 5% %
Up to 5 years	2.52	1.56
Over 5 years	1.56	1.39
5 – 15 years	2.08	1.78
Over 15 years	1.31	1.21
All stocks	1.59	1.39

# RPI inflation or earnings inflation?

- 100 per cent principle
- Section 2(8) of the Damages Act provides that PPs should vary by reference to RPI. However, section 2(9) provides for the possibility of section 2(8) being disapplied but gives no guidance as to when that might happen
- Flora v Wakom
- Thompsonstone v Tameside and Glossop Acute Services NHS Trust (and other cases)
- Differential between RPI inflation and earnings inflation



# Flora v Wakom

- July 2006
- Application by claimant to modify section 2(8) in favour of an index based on wages
- Application resisted by the defendant Allianz Cornhill on the grounds that the discretion to disapply the RPI should be used only in exceptional circumstances
- Court of Appeal refused to strike out the part of Mr Flora's claim that sought to link periodical payments to an index other than RPI
- No detailed evidence was heard on the relationship between RPI inflation and earnings inflation

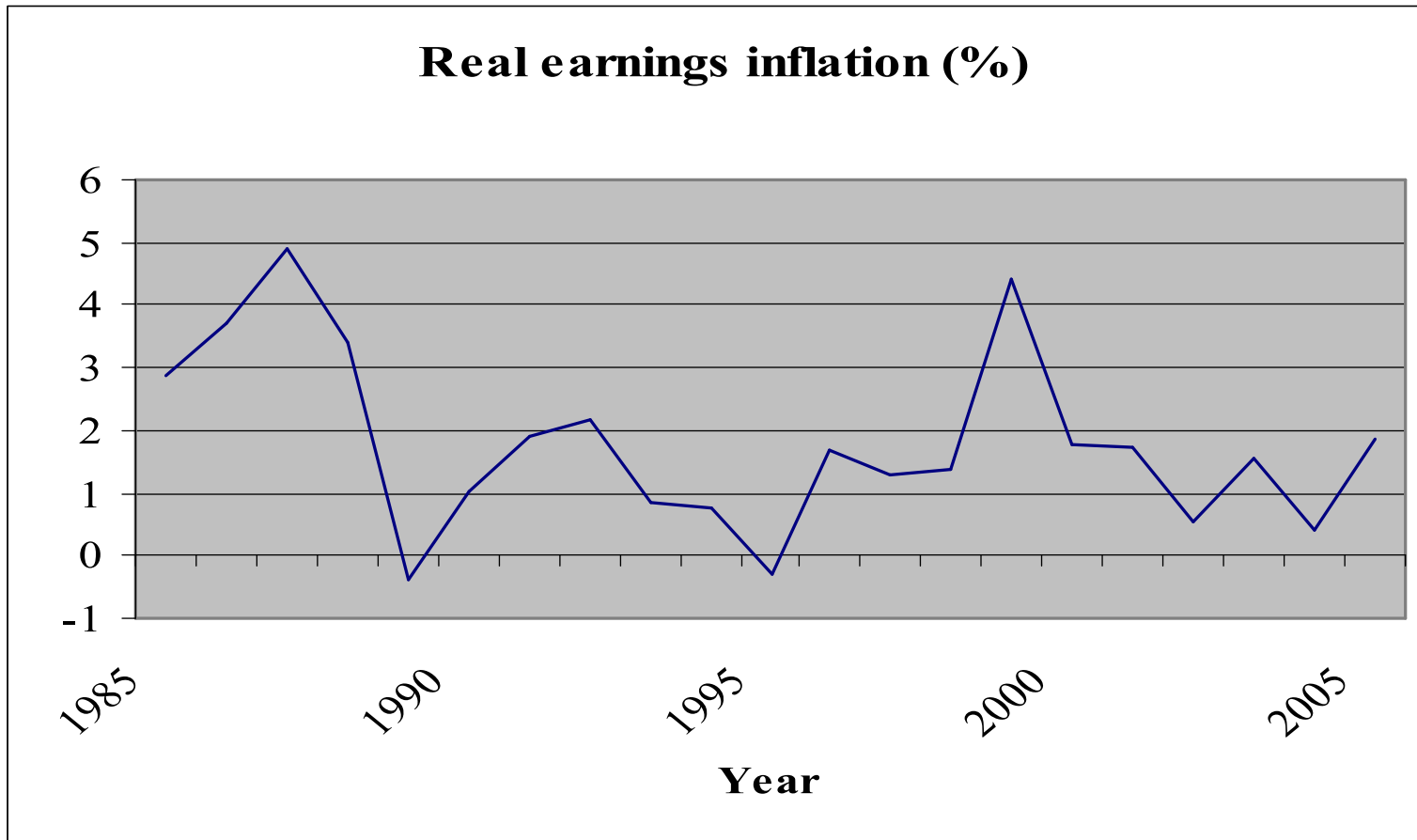
# Thompson v Tameside & Glossop (1)

- November 2006
- Claim for damages for major brain injury sustained at birth
- Defendant made range of submissions to justify maintaining RPI linking across all heads of claim
- These submissions were all rejected by the judge – agreed in principle with the argument that earnings inflation has traditionally exceeded RPI
- Heard evidence on three alternative approaches
- Care costs to be linked to Annual Survey of Hours & Earnings (75% percentile)
- Subject to appeal

# Thompsonstone v Tameside & Glossop (2)

- Increased costs of PPs linked to average earnings
- Expert evidence may be required in every case
- Funding issues
- Financial effect on insurers
- Also:
  - Corbett v South Yorkshire Health Authority
  - RH v United Bristol Healthcare NHS Trust

# Differential between RPI inflation and earnings inflation



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# Impaired life annuities

- Availability of annuities in the market
- Models of impaired mortality experience:
  - Multiple of base mortality table
  - Constant addition to base mortality table
  - Reducing addition to base mortality table
- Future mortality improvements:
  - Unimpaired lives
  - Impaired lives
- Practical considerations

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# Sixth edition of the Ogden Tables

- Published 3 May 2007
- Two main changes
  - Pecuniary loss and loss of pension multipliers increased
  - Revised calculations for contingencies other than mortality



# Pecuniary loss and loss of pension multipliers

- GAD based analysis on National Population Projections 2004
- One table for UK as a whole
- Loss of earnings multipliers increased by 0%-4%
- Loss of pension multipliers increased most for younger claimants

# Ogden multiplier – Future cost of care (2.5% real yield)

Male aged	Ogden 5	Ogden 6	Increase %
20	31.30	31.63	1.1
30	28.81	29.05	0.8
40	25.61	25.79	0.7
50	21.65	21.86	1.0
60	16.98	17.30	1.9

# Contingencies other than mortality

- Applies to loss of earnings head of damage (and also in theory future loss of pension entitlement)
- New research by Verrall, Haberman, Butt, Wass
- Ogden 5:
  - Separate factors for high, medium and low levels of economic activity
  - Adjustments to allow for occupation and geographical region
- Ogden 6 contains separate discount factors for:
  - Educational attainment
  - Employed / not employed
  - Disabled / not disabled
  - Male / female
- The factors are intended to be a starting point

# Educational attainment – 3 grades

- D: Degree or equivalent or higher
- GE-A: GCSE grades A to C up to A levels or equivalent
- O: Below GCSE grade C or CSE grade 1 or equivalent or no qualifications
- Previous factors of type of occupation, geography and economic activity much reduced effect so excluded

# Definition of disability

- Has either a progressive illness or an illness which has lasted or is expected to last over 1 year
- Disability substantially limits the ability to carry out normal day to day activities
- Condition affects either the kind of work or amount of paid work they can do

## Contingencies other than mortality – discount factors (Male - educational category O) – Ogden 6

Age	Not disabled Employed	Disabled Employed	Not disabled Not employed
20	0.87	0.38	0.83
30	0.89	0.40	0.81
40	0.88	0.39	0.78
50	0.83	0.40	0.70

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## Ogden 6 multiplier – future cost of care

Male aged	2.5% real yield	1.5% real yield	Increase %
20	31.63	40.86	29.2
30	29.05	36.39	25.2
40	25.79	31.26	21.2
50	21.86	25.60	17.1
60	17.30	19.57	13.1



# Potential broad illustration of financial impact on insurers and reinsurers

- Various assumptions
- Around 5% increase in total gross motor outstanding claim reserves
- Much lower increase in net claim reserves
- Around 2% increase in total gross motor claim costs
- Geared impact on motor reinsurance companies
- Also potentially applicable to EL, PL and medical malpractice claims

# Issues for insurers

- Periodical payments effectively expose insurers to a 1% to 1.5% real yield (pre recent judgments), although they can invest in riskier asset types
- Periodical payments expose insurers to the full extent of future mortality improvements
- Out-of-court settlements will inevitably reflect these issues to some extent
- Difficulties in hedging risk
- Administration of annuity payments
- Additional capital requirements

# Reinsurance issues for periodical payments

- Relatively little has been resolved
- Key issues to be resolved:
  - How will reinsurance respond?
  - Longer to hit retention and increased credit risk
  - Commutation or capitalisation of exposures (some movement in this area?)
  - Mandatory commutation clauses?

# Potential impact of Ogden 6

- Overall impact on claimants
  - “Winners” will be those in employment, fit and having a good education
  - “Losers” will be those unemployed, disabled and having a low education
- Significantly greater discounts to loss of earnings multipliers
- Greater discounts arise from longer periods of unemployment
- Multipliers for residual loss of earnings based on health at date of assessment, not pre-existing health



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