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# GIRO50 Conference 2023

1–3 November, EICC Edinburgh

# Questions for you - Slido

## Participants can join at slido.com with **#3571016**

Do you have a view on when the new Ogden discount rate will be announced in England and Wales?

If the next ODR is a single rate, what do you think it will be?

If a dual rate system were to be introduced, what term do you think would be considered the most appropriate ‘switch over’ point?

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# Introductions – Working Party Members

**Badar Ali**
Medical Protection Society

**Ricky Childs**
Apollo

**Andrew Corner**
PwC

**Alex Hamilton**
Aviva

**Lauren Keenan**
Allianz

**Mohammad Khan**
PwC

**Nancy Li**
Zurich

**Eoin Lynch**
PwC

**Grant Mitchell**
Soteria Insurance

**Francisco Sebastian**
Independent

**Gower Wisdom**
AUL Assurance

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# Agenda

- Introduction
- Background to the Ogden Discount Rate (ODR)
- Dual / Multiple rate systems for the ODR
- Our ODR WP 2023 Survey Results
- What might the ODR be now?
- Conclusion

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# Introduction

Mohammad Khan

# Background to the Ogden Discount Rate (ODR)

Andrew Corner

# Timelines for discount rate reviews

**UK General Election due** - may impact the timing of any ODR announcements

## *England and Wales*

**July 2023**
Review has commenced with initial publication of call for evidence responses

**15 July 2024**
Latest date for < 180 day ODR review to begin (5yrs after the prior rate concluded)

**11 Jan 2025**
Expiry of < 180 day review period **i.e. latest date for new ODR(s)**

## *Scotland and NI*

**1 July 2024**
Day specified for <90 day review to begin (5yrs after previous review began)

**29 Sep 2024**
End of <90 day review period

**1 Oct 2024**
**Likely date for new ODR(s)** (5yrs after previous rates set)

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# Ogden Discount Rate expert panel

*Appointed by the Lord Chancellor*

Due to takeover as Government Actuary from the end of 2023

**Fiona Dunsire**

Government Actuary

**Martin Clarke**

**Charl Cronje**

Actuarial

**Donald Taylor**

Investment Management

**Dr Rebecca Driver**

Economics

**Edward Tomlinson**

Consumer matters

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# Setting the new Discount Rate

*Considerations*

Fairness to all stakeholders

Single vs multiple rate(s)

Economic, long term inflation, financial forecasts

Investment portfolio – mix and duration

Tax and investment management costs

Consultation of a panel and the Lord Chancellor with different areas

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# Dual / Multiple rate systems for the ODR

Grant Mitchell

# Background to Dual / Multiple rates

*Current single rate methodology may be changing*

- The current, single rate methodology may:
  - overcompensate those with **long** expected life spans
  - And undercompensate those with **short** ones.
- GAD explored the issue of dual/multiple rates during the last ODR review in **2019**
- The review noted that a dual rate may lead to **more equal outcomes** and there were good technical reasons to adopt a dual rate
- However, the Government decided that there was a **lack in the quantity and depth of evidence** available at that time to conclude that a dual rate was more appropriate than a single rate
- A commitment was, therefore, made to seek additional data and evidence on this issue to inform future ODR reviews.

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# Evaluating approaches to a Dual/Multiple Rate system

*Understanding the impacts*

<table>
<tr><th>Varies with duration</th><th>Varies depending on the heads of loss</th><th>Both</th></tr>
<tr><td>Advantages:<br>• More accurately reflects expected investment behaviour<br>• Allows for varying attitudes to risk for short and long term claimants<br>• Allows for variations in short and long term economic conditions<br>• Leads to fairer outcomes for both sides</td><td>Advantages:<br>• Can more accurately reflect the different inflation measures<br>• Could lead to increased data capture for compensators</td><td>Advantages:<br>• The legislative framework already allows for the introduction of a dual/multiple rate system.</td></tr>
<tr><td>Disadvantages:<br>• Short-term discount rate is likely to be more volatile than the current single rate<br>• Could lead to the need for more frequent reviews of the short-term rate at least<br>• The availability of PPOs means that a dual/multiple rate is unnecessary<br>• A dual rate could produce a short-term rate which is very low</td><td>Disadvantages:<br>• Arguments that each heads of loss would need a separate rate which could become very complex or result in “gaming the system”</td><td>Disadvantages:<br>• Multiple rate structures will introduce additional complexity<br>• Will require an increased number of assumptions to be made<br>• Implementation costs and increased operational complexity</td></tr>
</table>

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# Switch-over point

*A key choice when implementing a multiple rate system varying by duration*

- If the switch-over point is **too short** (for example, 5 years), this would result in two very differentiated segments:
  1. the very short one (0 to 5 years), in which any form of **risk taking would be discouraged** for lack of investment horizon
  2. a very long one (over 5 years), which would likely lead to **differentiated investment strategies** for different types investment horizons, so the longer-term rate would have to reflect a very **heterogeneous mix of strategies**.

- If the switch-over point is **too long** (say 20 years), this would result in **heterogeneous grouping** in the first segment.

- The average economic cycle in the UK since 1970s has been **9.6 years**, although cycle lengths can vary greatly.

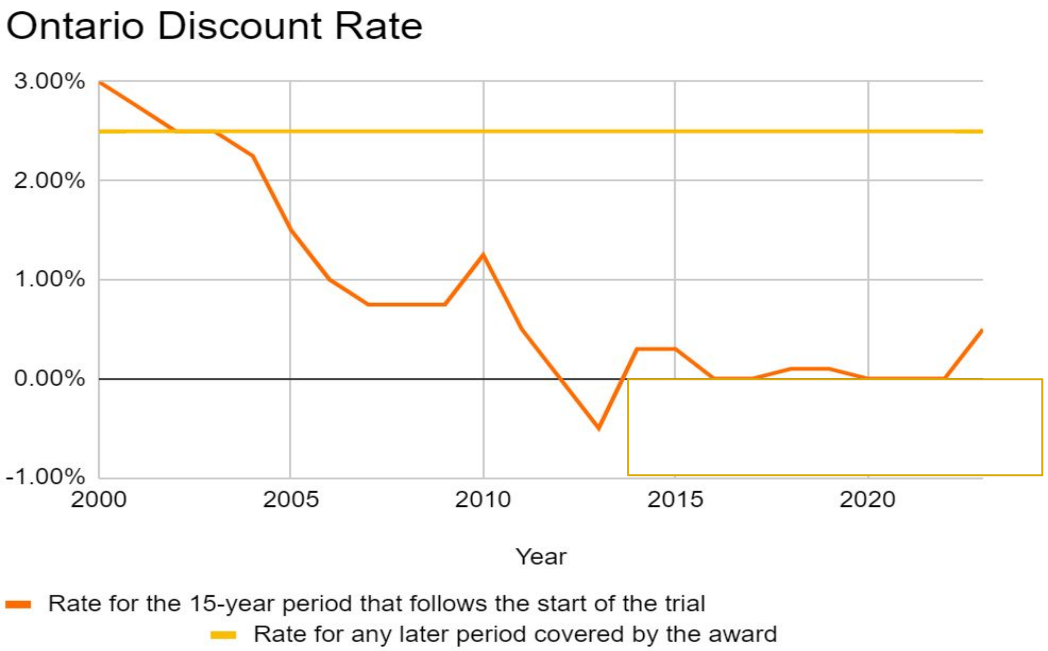
- A switch-over point a little shorter or longer than this optimal point might be acceptable – within a range of perhaps **7-15 years**.

- The aim would be for the longer-term rate to be **relatively stable** and not influenced by cyclical effects, whereas the short-term rate is reflective of **current conditions**.

# Ontario Discount Rate

## *Real world case study on a dual rate system*

- The Canadian province of Ontario has had a dual rate system for calculating the ODR since 1999. This consists of a short-term rate and a long-term rate, with the switching point period fixed at 15 years.
- The Ontario model is designed to blend one component that is current economic conditions (the short-term rate) with a second element that anticipates reversion to a long-term average (the long-term rate).
- The short-term rate is calculated on the basis of whichever is greater for the 15-year period following the start of the trial of either:
  - the average of the value of the real rate of interest on long-term Government of Canada real return bonds, in the year before the year in which the trial begins, less half a per cent and rounded to the nearest tenth of a per cent; or
  - Zero
- The current short-term rate (2023) is 0.50%, and the long-term rate is plus 2.5%. It is instructive to note that in the 22 years since the dual rate system was introduced, the short-term rate has been amended 16 times, but the long-term rate has remained unchanged.

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# Government Call for Evidence

*MoJ issued a Call for Evidence in Jan 2023 to explore dual / multiple Discount Rates*

- On 11 September 2023 the Government issued a response document summarising the 65 responses received, however, this document **did not issue formal advice**
- The Scottish Government and the Department of Justice for Northern Ireland have also been consulting on this and other aspects of the Discount Rate calculation ahead of the next formal review.

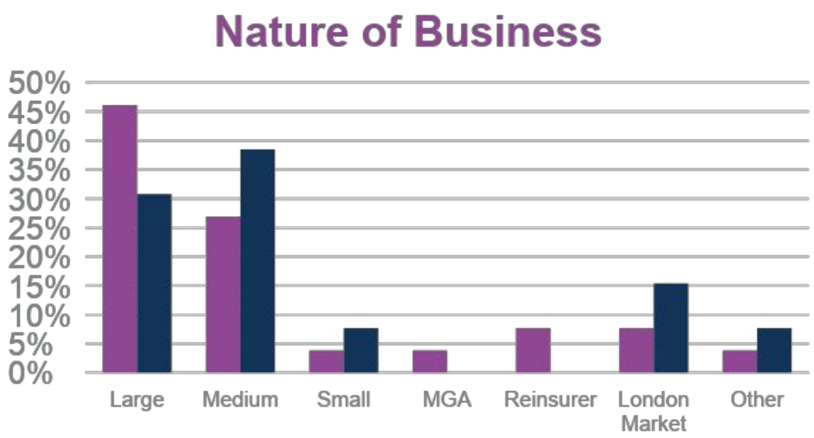
Key takeaways:

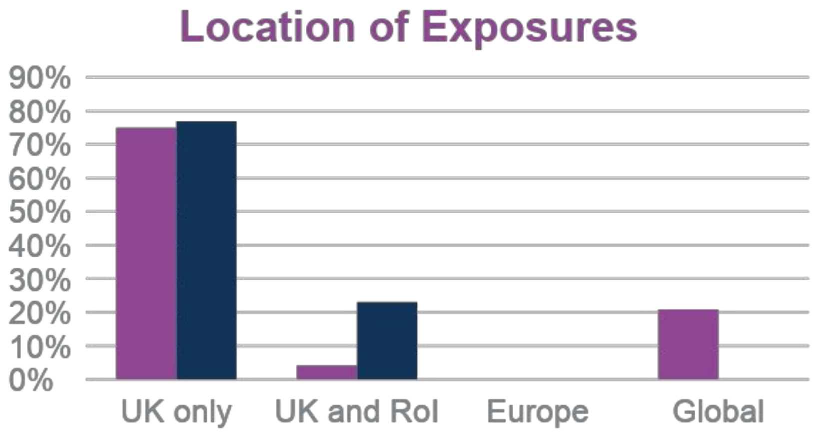
- Publications from the reviewing panel have yet to offer any opinions or formal guidance on the introduction of a dual/multiple rate
- Views from the (re)insurance industry **do not appear as well aligned** as those from the claimant lobby
- The volume and diversity of views presented is indicative of the challenges ahead

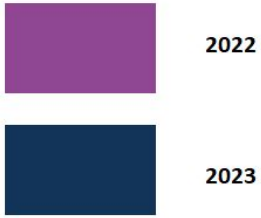
# Our ODR WP 2023 Survey Results

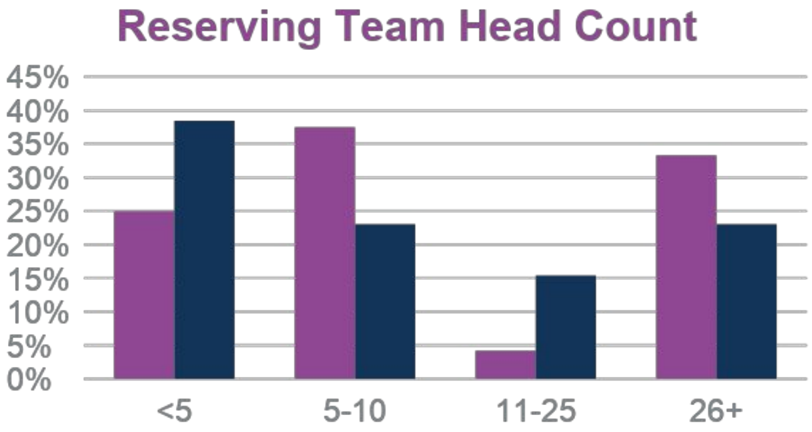
Nancy Li

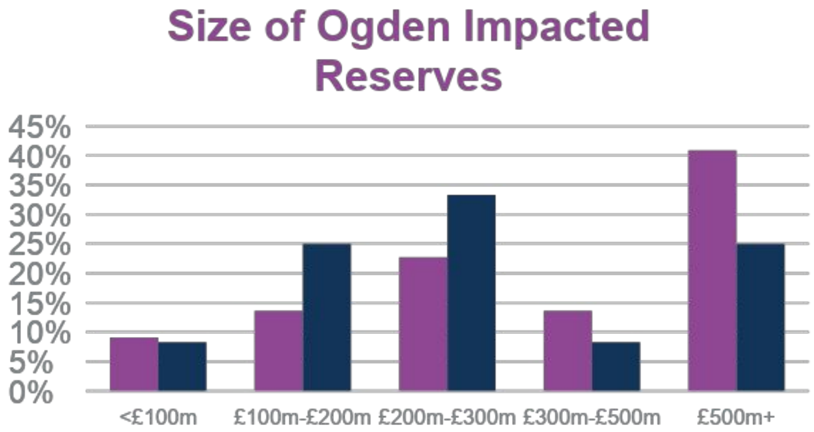
# Respondents primarily medium-sized insurers




## Compared to 2022 survey:

- Reduced no. of responses
- Greater proportion of **Medium** and **London Market** responses reflected in the lower Reserving Team Headcount and smaller Ogden reserves.

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# Survey themes

- Respondents felt that a dual/multiple rate would be fairer for both claimants and (re)insurers…

…with the Ontario method considered optimal by the majority of respondents

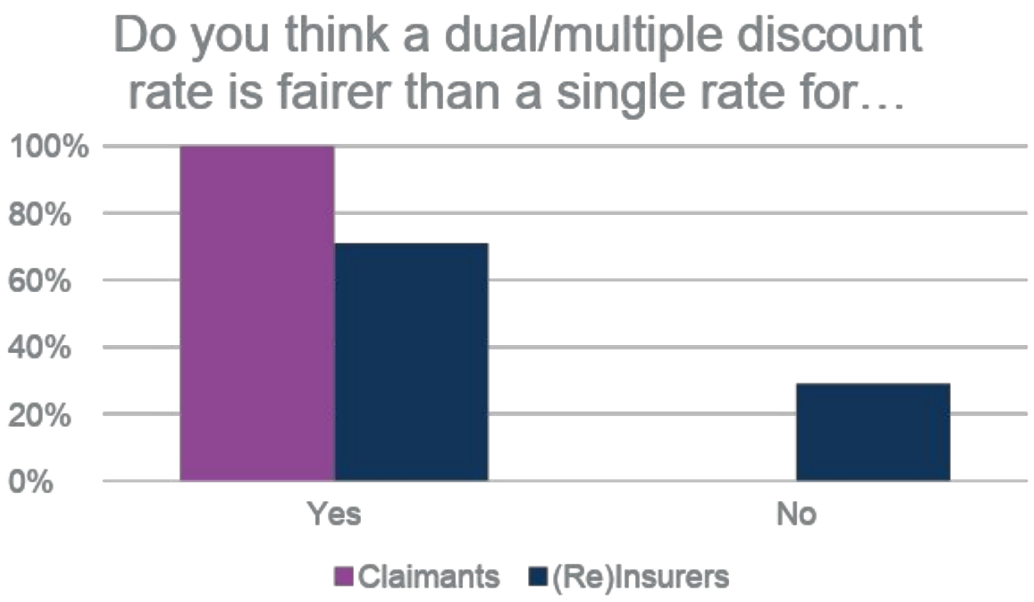
- Respondents felt the ODR is likely to increase…

…while no respondents have yet allowed for a change in ODR in their current reserving or pricing for England and Wales exposure

- A greater proportion of respondents felt that the ODR had more impact in driving settlement discussions…

…it may be that as the review approaches, it becomes more of a consideration in settlement discussions.

# A dual rate is fairer to all parties but not necessarily preferred over a single rate




- Respondents felt that a dual/multiple rate **would be fairer** for both claimants and (re)insurers
- However, owing to the added complexities of a dual/multiple rate, a small majority would prefer a single rate
- We asked respondents if a multiple rate were to be introduced what method would be the optimal way of doing so, and the most popular response was the **Ontario method**
- As was the case in 2022 no respondent said that they explicitly quantify their reserves under a dual rate scenario
- Most respondents said that they were not yet ready to implement a dual rate in their processes but there is a small improvement in responses since last year

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# Mixed engagement with MoJ call for evidence

- Around half of the survey respondents responded to the MoJ's call for evidence either directly or through another industry body
- However no respondents said that they were definitely intending to lobby the Expert Panel, half saying they wouldn't and half saying they were unsure
- Respondents believe that the Expert Panel will have influence over almost all aspects of the discount rate framework with specific mention of the 0.5% prudency margin, the dual discount rate method and investment and inflation assumptions.

*"[Does] the extra 0.5% for uncertainty… remain"*

*"What inflation rates to assume both short and long term"*

*"The type of dual discount rate method applied"*

*"Investment portfolio and assumptions"*

- Respondents also believe that the 0.5% prudency margin will remain static but some felt it should not be included at all.

*"In principle [it] shouldn't be needed as [it] deviates from [the] 100% compensation principle."*

*"… also consider that if a claimant is very risk adverse, the PPO option remains a viable option"*

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# Slido

## Participants can join at slido.com with #3571016

If a dual rate system were to be introduced, what term do you think would be considered the most appropriate ‘switch over’ point?

- Less than 5 years
- 5 - 10 years
- 10 - 15 years
- 15 - 20 years
- 20+ years

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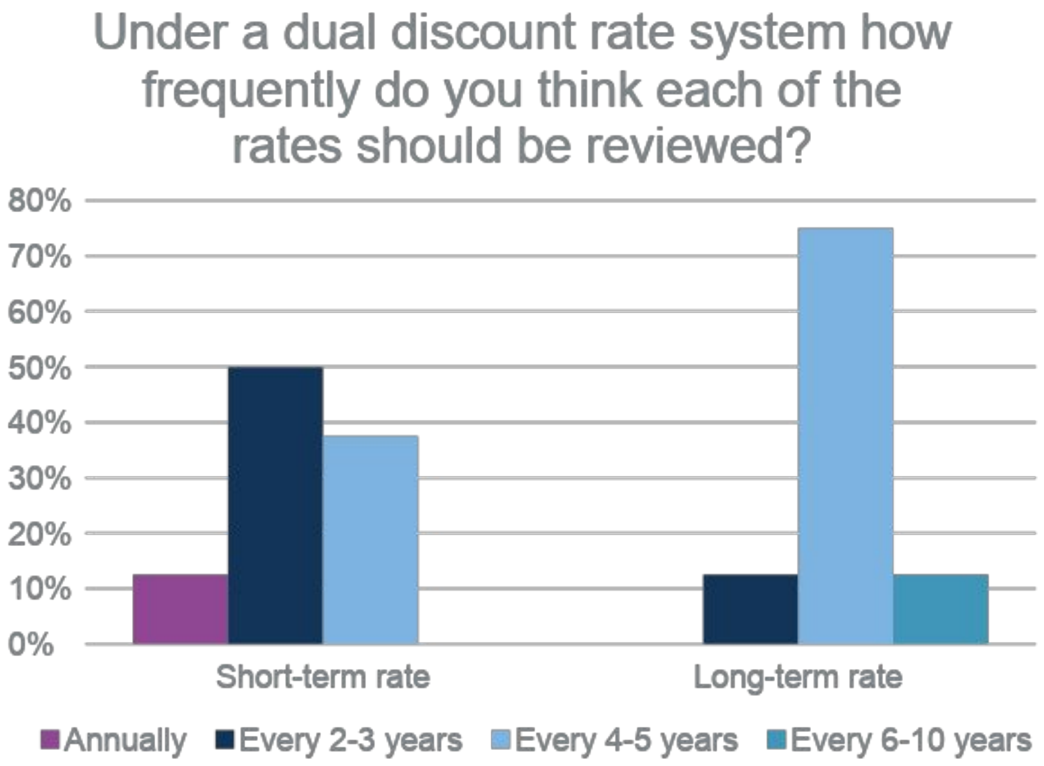
# 10-15 years is generally seen as the most appropriate 'switch over' point




- Respondents were fairly unanimous in suggesting that an appropriate 'switch over' point would be **between 10-15 years**
- The consensus is that the framework of a dual/multiple rate should be **considered less frequently** than the standard review cycle
- Respondents suggested that the short term rate should be reviewed every 2-3 years, while the long term rate should be reviewed every 4-5 years

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# Slido

## Participants can join at slido.com with #3571016

- Question:

Do you have a view on when the new Ogden discount rate will be announced in England and Wales?

  - Q1 2024 / Q2 2024 / Q3 2024 / Q4 2024 / Q1 2025 / Q2 2025

- Question:

If the next ODR is a single rate, what do you think it will be?

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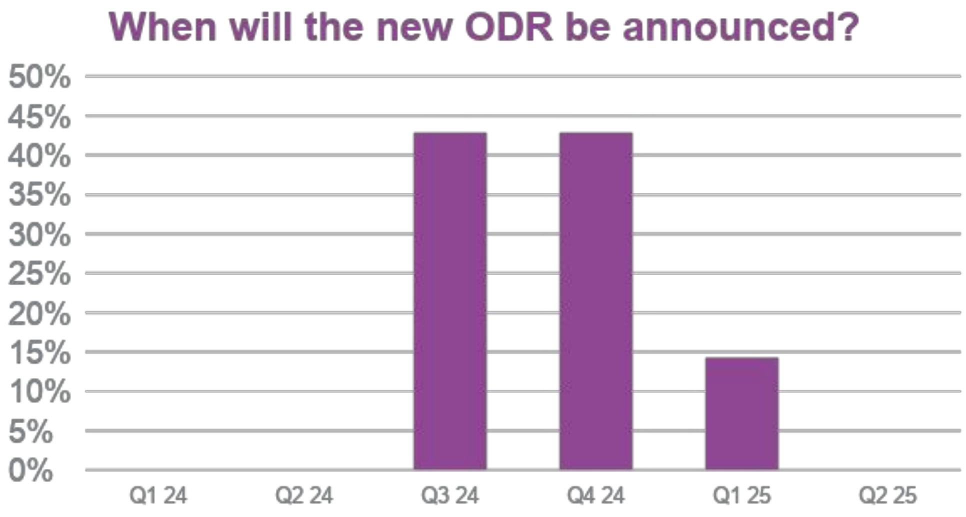
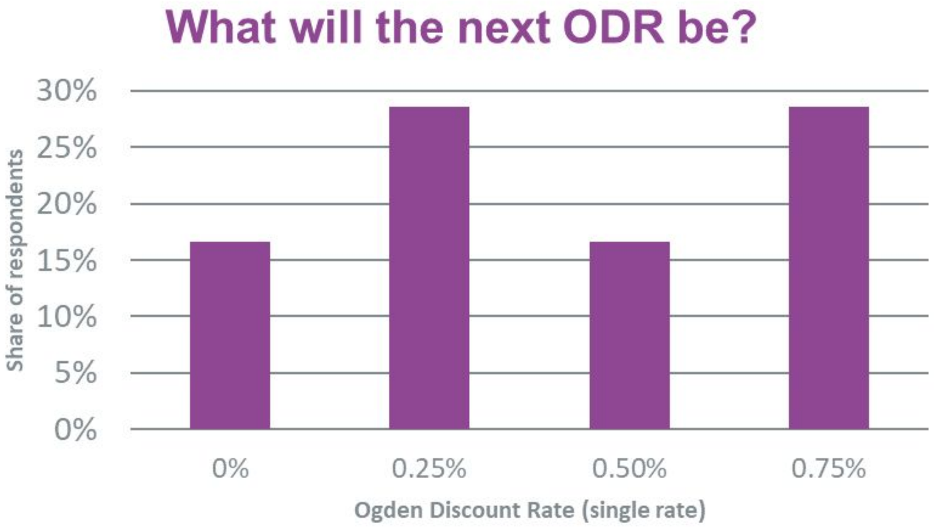
# Expectations of an increased ODR to be announced in Q3 or Q4 2024




- Most respondents felt the ODR is likely to increase
- However no respondents have yet allowed for a change in ODR in their current reserving or pricing for England and Wales exposure
- Almost 90**% of respondents expect to start allowing for a change in ODR in 2024** with the remaining 10% expecting to allow for a change only when the new ODR is announced
- Respondents were split on whether the new ODR would increase or have an immaterial impact on the no. of PPOs settled.




*"No change at [the] moment. [We] will consider sensitivities for year-end depending upon [our] own view and what [the] Working Party say in their 2023 GIRO paper"*

*"There is still a lot of potential variability"*

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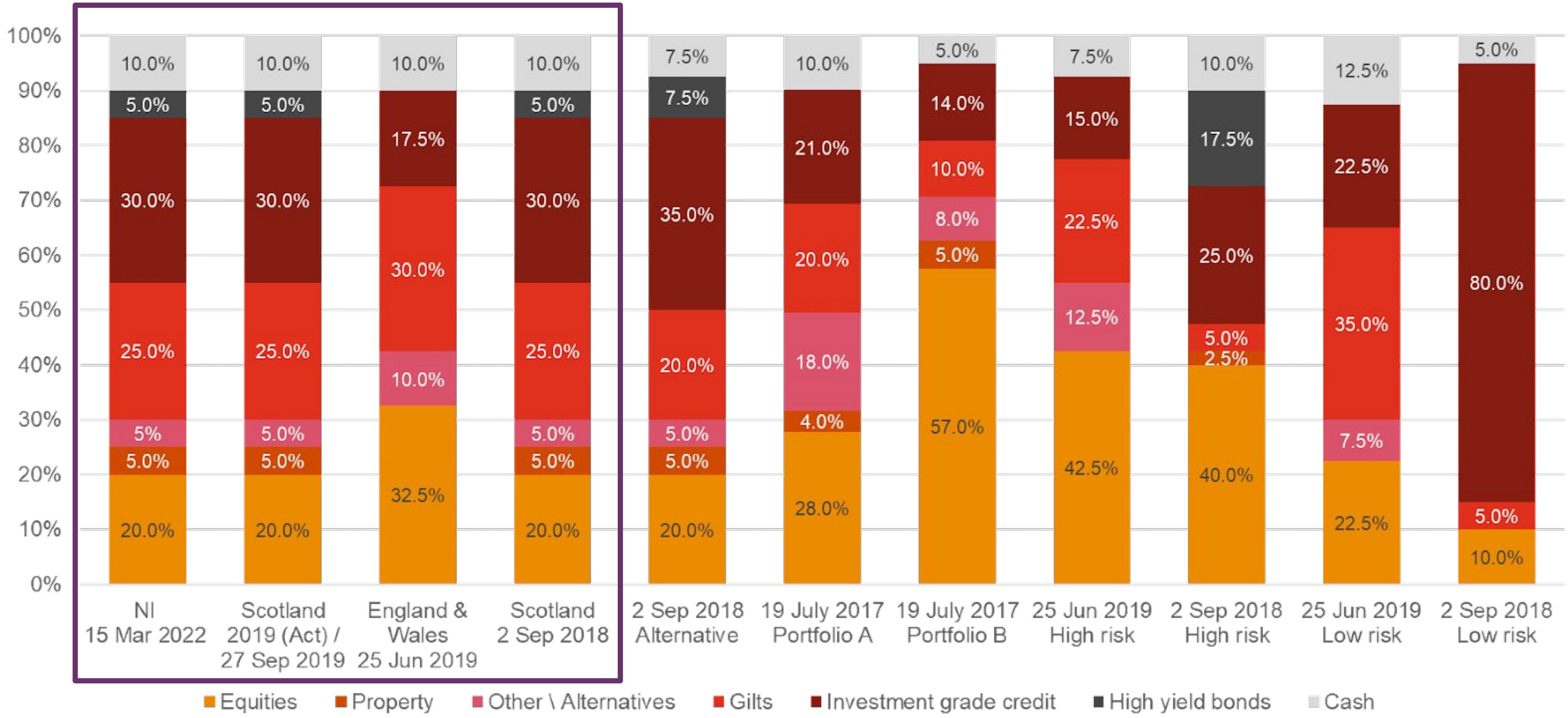
# What might the ODR be now?

Andrew Corner

# Government Actuary's Department approach (2019)

*Portfolio mix as at previous review*




Source: PwC

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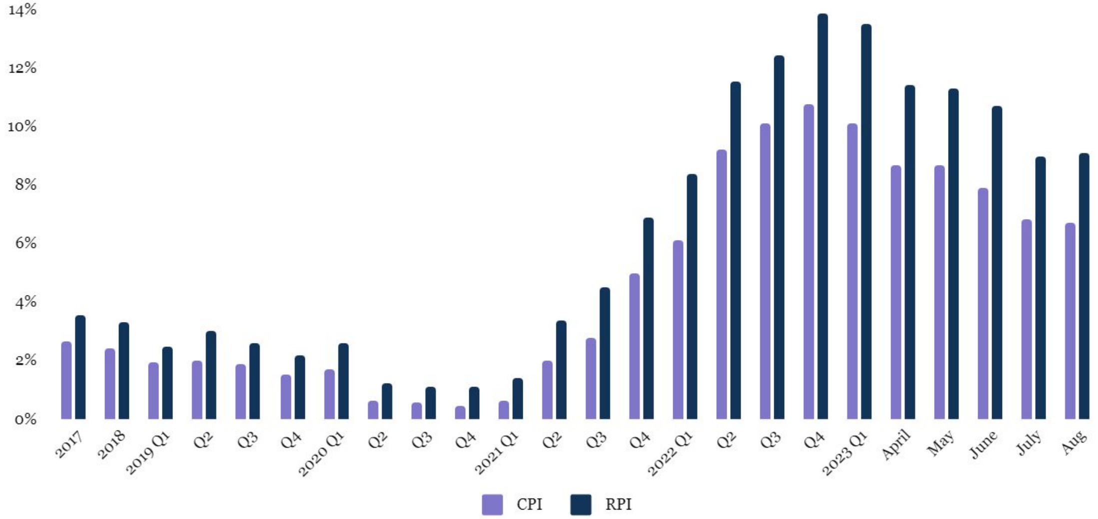
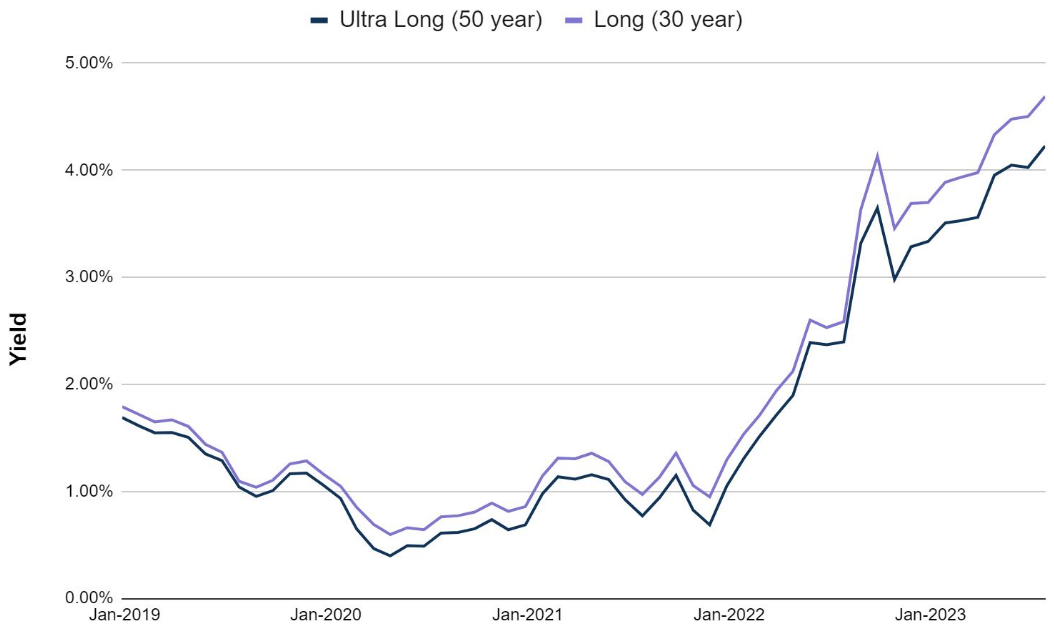
# Economic indicators




UK CPI and RPI annual inflation rate data: Inflation remains high, however Bank of England, IMF and OECD forecasts all anticipate a return to the 2% level in 1-2 years time

Comprising roughly 30% of the GAD portfolio, gilts would represent a key driver of the updated ODR if calculated using the same approach as used in the 2019 review

Source: Office for National Statistics

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# Potential Updated ODR (assuming unchanged methodology)

*If re-estimated now, the ODR for England and Wales would likely be positive.*

| | GAD's conclusions (2019) | Working Party Oct 2023 view |
|---|---|---|
| Expected return | 4.00% | 5.00% |
| Inflation (CPI) | -2.00% | -2.00% |
| **Real Expected Return** | **2.00%** | **3.00%** |
| Tax and Expenses | -0.75% | -0.75% |
| Damage inflation | -1.00% | -1.00% |
| **Return post DI, T and E** | **0.25%** | **1.25%** |
| Political adjustment (extra margin) | -0.50% | -0.50% |
| **Estimated ODR** | **-0.25%** | **0.75%** |

Having risen by roughly 3% at the 43 year duration, nominal gilts alone could add roughly 1.00% to the Expected return today

Our estimation assumes GAD's methodology **remains unchanged** from 2019 and that **only gilts** are driving changes in this expected return.

There are significant other uncertainties on other potential changes including on inflation and the Political adjustment as well as whether dual-rate is used.

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# Impact of a ODR change in England and Wales

*We have modelled the reduction in the average premium per policy if the ODR was to increase*

- We applied the Ogden tables using average multipliers for 20 to 50 year olds and assumed that the reduction in large claim amounts due to a ODR increase would be **passed on in full** to policyholders

- We assumed an average cost per claim, average premium per vehicle year and average frequency of large claims per vehicle year based on the PwC Market Views and a PPO propensity of 10% (PPO Working party).

| Increase in ODR | 0.25% | 0.75% | 1.25% | 1.75% | 2.25% | 2.75% |
|---|---|---|---|---|---|---|
| Estimated impact per policy (%) | -1% | -4% | -6% | -8% | -9% | -10% |
| Estimated impact per policy (£) | -£5 | -£13 | -£20 | -£26 | -£30 | -£34 |
| Estimate industry wide impact (£) | -£180m | -£490m | -£750m | -£960m | -£1,140m | -£1,290m |

**Our Estimate:** → **+1.00%**

Change in ODR vs 2019 rate

**- £17** Per policy impact

**- £620m** Industry wide impact

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# Conclusions

Mohammad Khan

# Overall Conclusions

- Assuming unchanged methodology, a possible range for the ODR is between **0% and +1.5%**
  - The timing of the calculation can affect results meaningfully
  - Long term inflation expectations are a key part of the calculation
- Most respondents to our survey believe the ODR will be a **single rate between 0% to +0.75%** at the time of the survey (August 2023), with an announcement expected in **H2 2024**
- No respondents are currently allowing for a change in discount rate in their reserving / pricing, and most expect to start allowing for changes in 2024 (ahead of the announcement)
- Most firms processes and systems are **not ready or are only "partially" ready** to handle dual/multiple discount rate, however, there are indications of progress compared to last year
- The **Ontario method** is considered an optimal dual rate system by most respondents.

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# Next Steps

- Monitor any announcements on a change to the ODR
- Review government / GAD publications and expert panel meeting minutes
- Consider how to reserve in a dual rate environment

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Questions

Comments

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# Thank you

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# The Ogden Discount Rate Working Party