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# GIRO Conference 2022

21–23 November, ACC Liverpool

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# The Ogden Discount Rate Working Party

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# Introductions – Working Party Members

**Badar Ali**
Medical Protection Society

**Ricky Childs**
Apollo

**Andrew Corner**
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**Nancy Li**
Zurich

**Grant Mitchell**
Soteria Insurance

**Francisco Sebastian**
Wellington Management

**Gower Wisdom**
AUL Assurance

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# Agenda

- Introduction
- Background to the Ogden Discount Rate (ODR)
- Our ODR WP 2022 Survey Results
- What would the ODR be now?
- Conclusion

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# Introduction

Mohammad Khan

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# Background to the Ogden Discount Rate (ODR)

Andrew Corner

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# Background

*Movement from discount rate of 2.5%*

## England and Wales

- **27 February 2017 (effective 20 March 2017)** : Discount rate set at -0.75%
- **19 July 2017** : GAD publishes report of claimant outcomes under different discount rates
- **20 December 2018** : Civil Liability Act comes into force
- **22 January 2019** : GAD memorandum sets out their analytical approach
- **25 June 2019** : GAD publishes report recommending a +0.25% discount rate
- **15 July 2019 (effective 5 August 2019)** : Discount rate set at -0.25%
- For England & Wales, the inflation measure used is **CPI + 1% damage inflation**

**Next review cycle must be complete by July 2024**

## Scotland

- **28 March 2017** : Discount rate set at -0.75% via The Damages (Personal Injury) (Scotland) Order 2017
- **5 September 2018** : GAD publishes report analysing different portfolios
- **24 April 2019 (passed 19 March 2019)** : Damages (Investment Returns and Periodical Payments) (Scotland) Act 2019 sets out notation portfolio, duration and adjustments
- **27 September 2019** : GAD publishes report concluding the discount rate should remain at -0.75%
- For Scotland, the inflation measure used is **RPI**

**Next review cycle must be complete by September 2024**

## Northern Ireland

- **May 2021** : Discount rate set at -1.75%.
- **2 February 2022** : Damages (Return on Investment) Act (Northern Ireland) 2022 comes into force
- **22 March 2022** : Discount rate set at -1.5% *[hypothetical rate under the previous methodology, would be -2.25%]*
- For Northern Ireland, the inflation measure used is **RPI**

**Next review cycle must be complete by July 2024**

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# Current Ogden Discount Rates

*Government Actuary's advice to the Lord Chancellor*

| | England & Wales | Scotland | Northern Ireland |
|---|---|---|---|
| Weighted return | 4.00% | 3.50% | 3.25% |
| Tax and Expenses | -0.75% | -0.75% | -0.75% |
| Return post Tax and Expenses | 3.25% | 2.75% | 2.50% |
| Inflation | -3.00% | -3.00% | -3.50% |
| **Real Return** | **0.25%** | **-0.25%** | **-1.00%** |
| Political adjustment for further margin involved in relation to the rate of return | -0.50% | -0.50% | -0.50% |
| **Ogden Discount Rate** | **-0.25%** | **-0.75%** | **-1.50%** |
| Date of review | July 2019 | September 2019 | March 2022 |

Higher weighted return in England & Wales driven by:

- a larger weighting to equities in the portfolio
- higher return across all asset classes

Higher inflation assumption for NI driven by economic conditions at the time of the discount rate review

The 0.5% adjustment is statutory in NI and Scotland, whilst in E&W it is a subjective adjustment applied by the Lord Chancellor

Lower NI rate driven by **lower weighted returns** and **higher inflation** assumption

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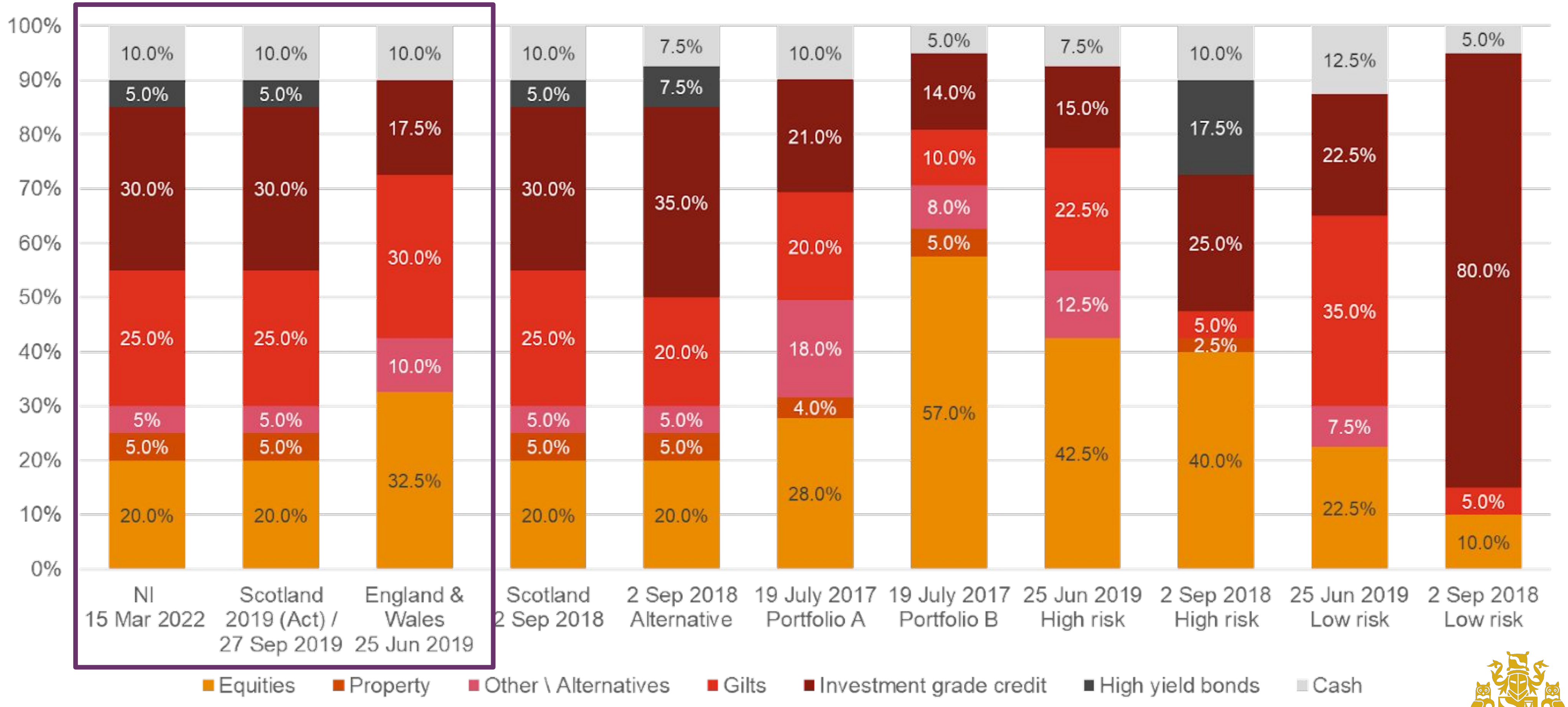
# GAD approach

*Portfolio mix*




Source: PwC

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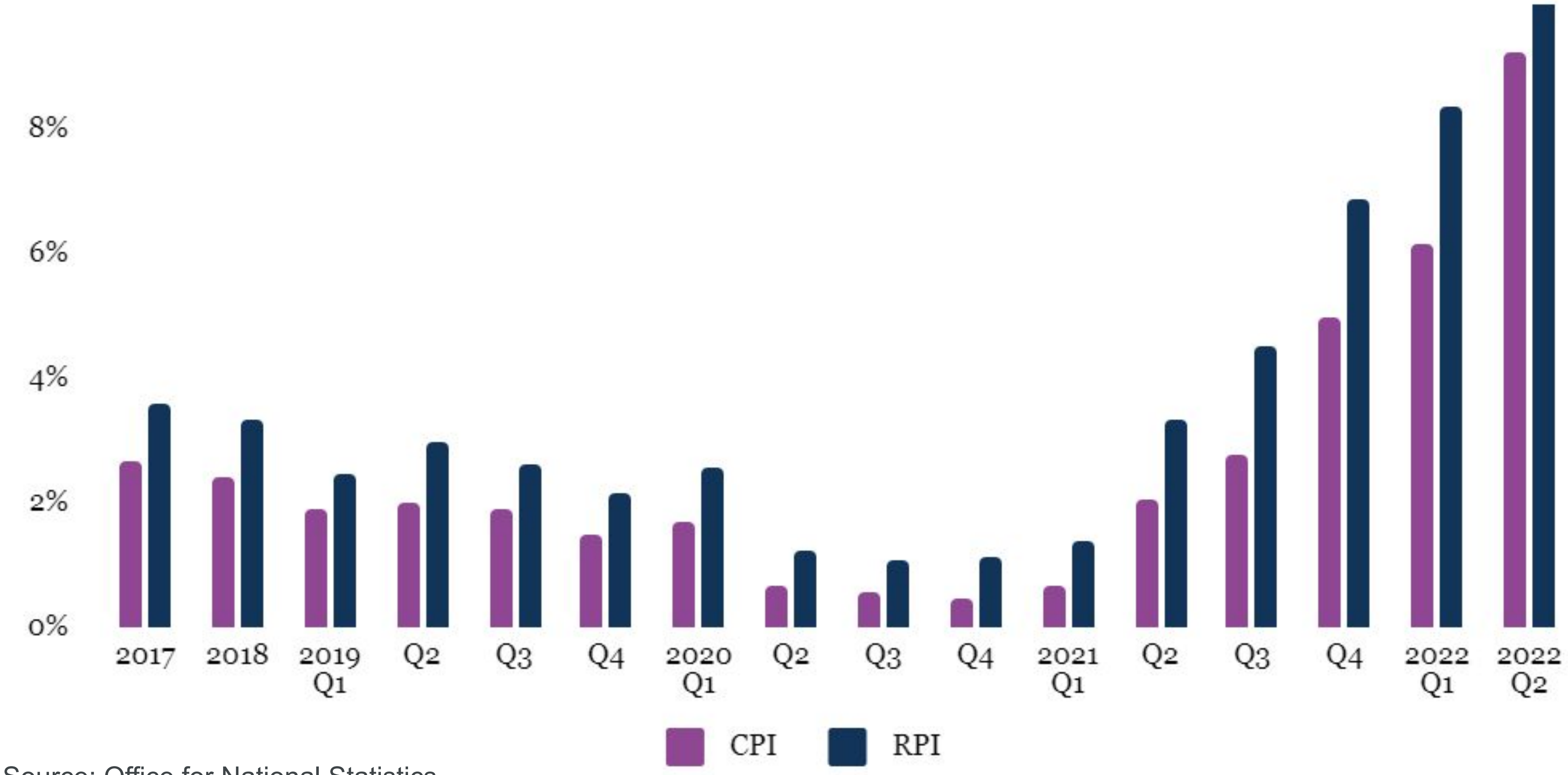
# Inflation

*Comparison of CPI and RPI inflation*




Source: Office for National Statistics

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# Next Steps for the ODR in England & Wales

- The **MoJ** will shortly be issuing a **call for evidence** to seek expert stakeholder input on the pros and cons of a dual/multiple ODR
- Ahead of this they are engaging with **industry professionals** through a number of **round table** events to provide additional information to the sector on what the call for evidence will entail.
- The review of the discount rate will last up to **180 days** from when the Lord Chancellor announces the review.
- In conducting the review, the Lord Chancellor must consult:
  - The **expert panel** established for the review, and,
  - The **Treasury**

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## Move to a Dual Rate?

- GAD previously considered a move to a dual rate in England & Wales but **too little information** to make a informed decision.

- The current methodology may:
    - overcompensate those with **long** expected life spans (up to 20%)
    - And undercompensate those with **short** ones (up to 5%)

- A dual rate may lead to **more equal outcomes** and there were good technical reasons to adopt a dual rate.

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# Our ODR WP 2022 Survey Results

Lauren Keenan
Ricky Childs

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# Survey themes

Survey responses are from August 2022, before the current **market turmoil** in the UK.

Respondents primarily **large composite insurers** with Ogden-impacted reserves of >£500m

(Re)Insurers using head of damage splits to revalue open reserves

Very **few radical changes** in reserving approach adopted with **various limitations** noted

Varying approaches to allowing for future ODR changes with **37%** of respondents allowing for a change in ODR in **reserving**…

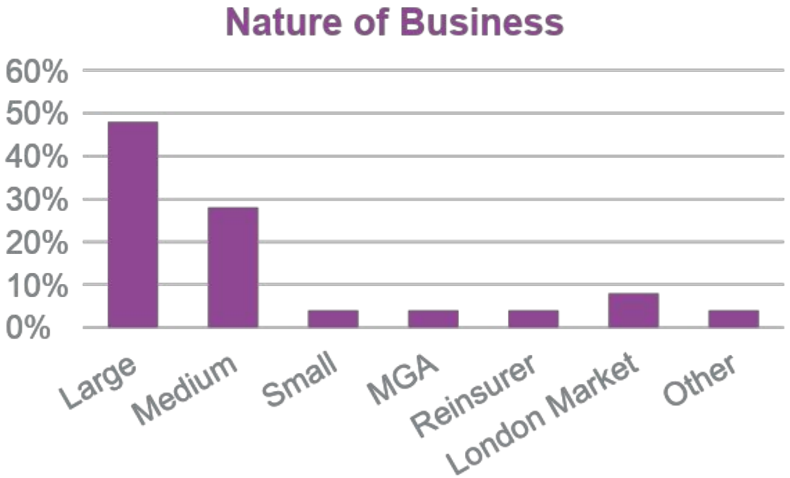
…whereas only **23%** of respondents are allowing for these changes in **pricing**

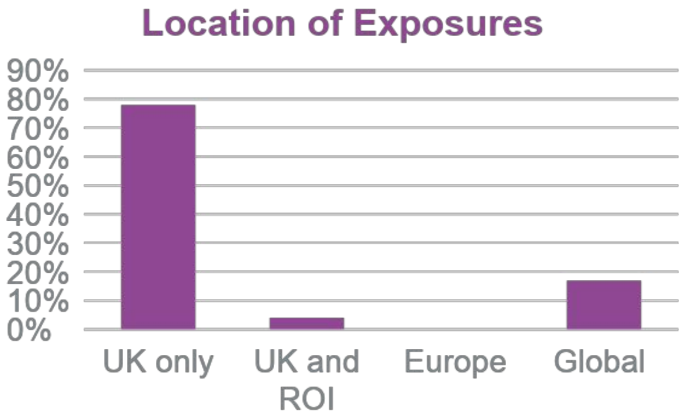
(Re)Insurers have kept similar RI retentions since the last ODR change with small price increases

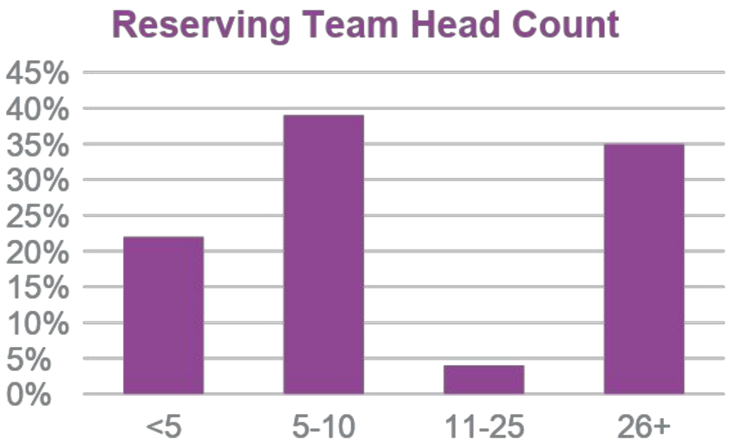
(Re)Insurers feel well-equipped to deal with a new ODR but are far **less prepared for a dual rate**

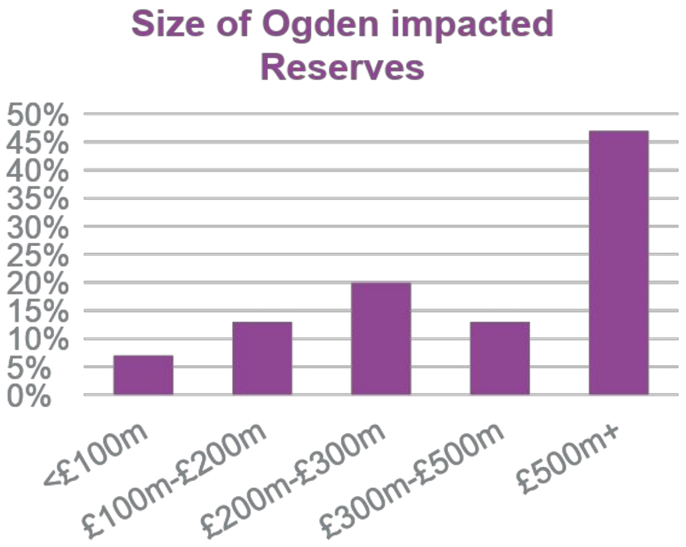
No consensus on importance of ODR in settlement negotiations

# Respondents primarily large composite insurers with Ogden-impacted reserves of >£500m




- Total Reserve size of 76% of respondents if **£500m+**
- Compared to the survey last year there is greater proportion of **Large / Composite** responses along with larger Reserving Team Head Count

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# (Re)Insurers using head of damage splits to revalue open reserves


- Most respondents have access to Heads of Damage (HoD) data but don’t use it in reserving- generally this approach hasn’t changed since the ODR changed
- 100% of respondents have the ability to revalue open reserves but **only 35% have the ability to revalue closed reserves**.
  - Most do this using granular claims data by HoD
- **67% of respondents** hold claim estimates on **different Ogden rate bases**- a greater proportion compared to 43% last year.

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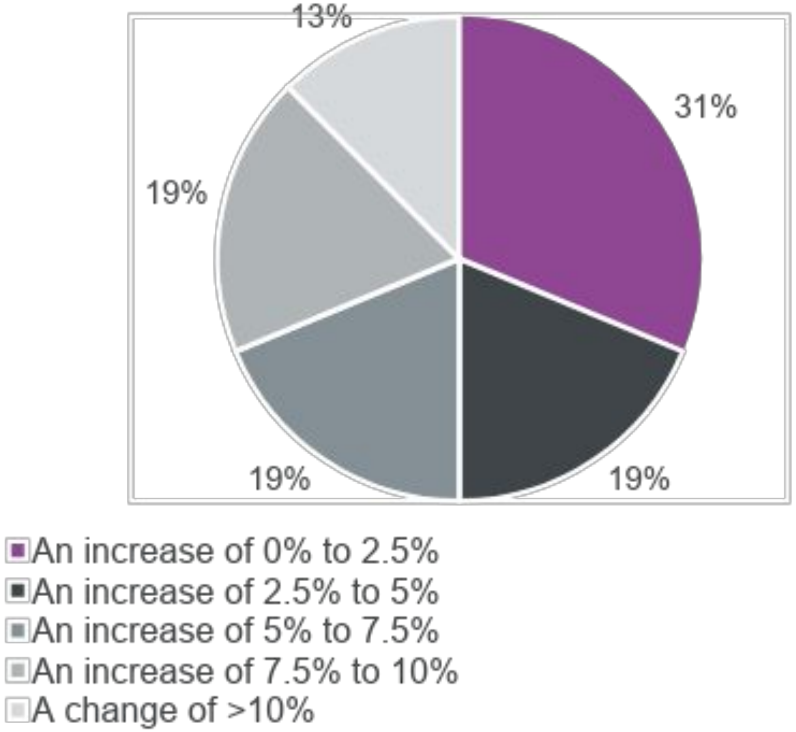
# Very few radical changes in reserving approach adopted with various limitations noted

**What % change in your reserves would you expect if the ODR = -1.0%?**




- **69%** of respondents (compared to 29% last year) reserve for an Ogden impacted book by **excluding diagonals** in claims triangles and assuming similar development pattern pre and post ODR change. **25% are re-basing claims** to be on a consistent basis (compared to 57% last year).
- **83%** of respondents have **made no changes in reserving approach** following ODR changes
- **47%** of respondents noted **data limitations** with their current methods
- **35%** noted issues with substantiating credibility
- Other concerns noted included knowing whether development pattern had changed given large claim volatility and difficulty of rebasing claims under a dual rate environment

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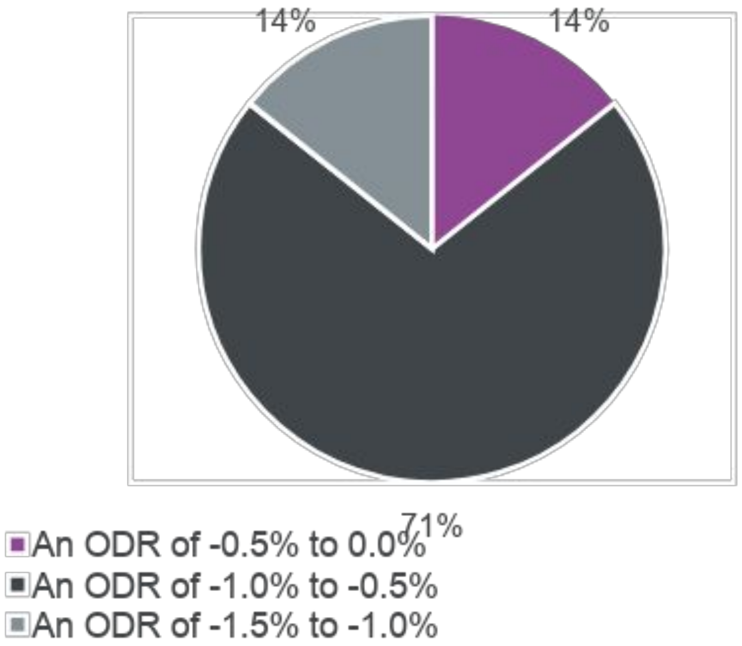
# Varying approaches to allowing for future ODR changes with 37% of respondents allowing for a change in ODR in reserving…

## What ODR are you allowing for?




- **37% of respondents** said that their companies **do allow for a change** in the ODR in current reserving.
  - Of these, most are making an allowance for a lower ODR of between **-0.5% and -1.0%**
  - **20% make a full allowance** when setting reserves, with the remaining **80% making a partial allowance**
  - **c.60%** of respondents allow for **Ogden reserves within their Best Estimates** (as opposed to Reserving Uncertainty Margin / ENID allowance).
- For those respondents whose companies do not yet allow for a change in the ODR, **42% expect to start allowing for a change in 2022** with the **remaining 58%** expecting to allow for a change **when it is announced**
- **No respondents** said that their companies have **quantified** the impact under a **dual rate scenario**

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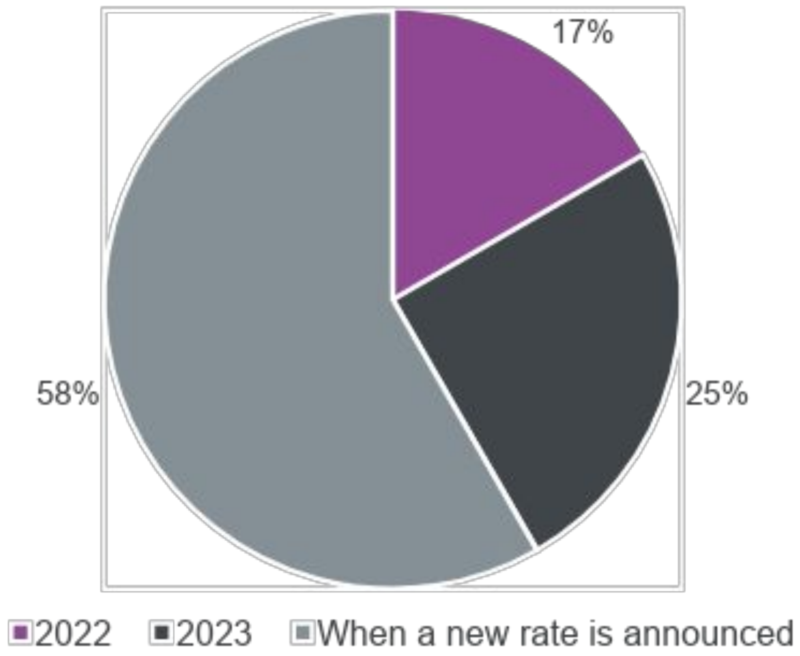
# …whereas only 23% of respondents are allowing for these changes in pricing

**When do you expect to start allowing for future changes in the Ogden discount rate in pricing?**




- Only **23% of respondents allow for a change in ODR in their pricing** with half of those using a rate between -1.0% and -0.5% and the other half using a rate between -1.5% and -1.0%

- Respondents who aren't yet allowing for a change in ODR in their pricing have mixed approaches as to when they plan to start:
  - 17% expect to start allowing for future changes in 2022
  - 25% expect to start in 2023
  - The remaining 58% expect to start only when a new rate is announced.

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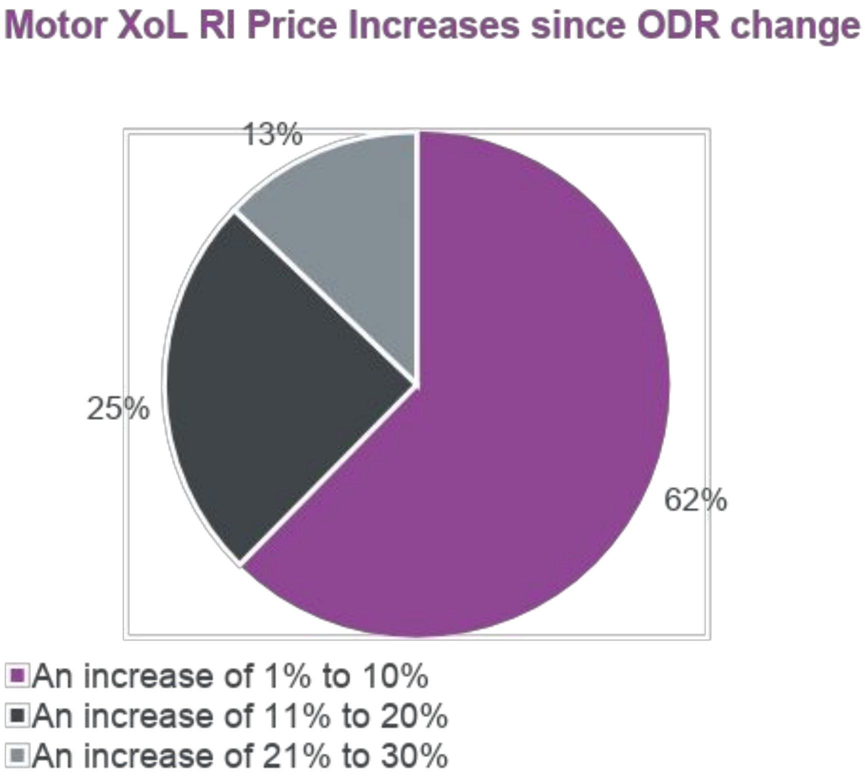
# (Re)Insurers have kept similar RI retentions since the last ODR change with small price increases




- 62% of respondents observed a price increase between **1%- 10%** on motor XoL RI since the ODR changed in 2019
- 38% of respondents believe motor XoL cover is the same value now vs 5 years ago and 38% believe it is slightly worse value
- 80% of respondents said that their motor XoL retention level is about the same as 5 years ago
- 57% of respondents said that concerns about future changes to the ODR affect decisions on RI to a small extent

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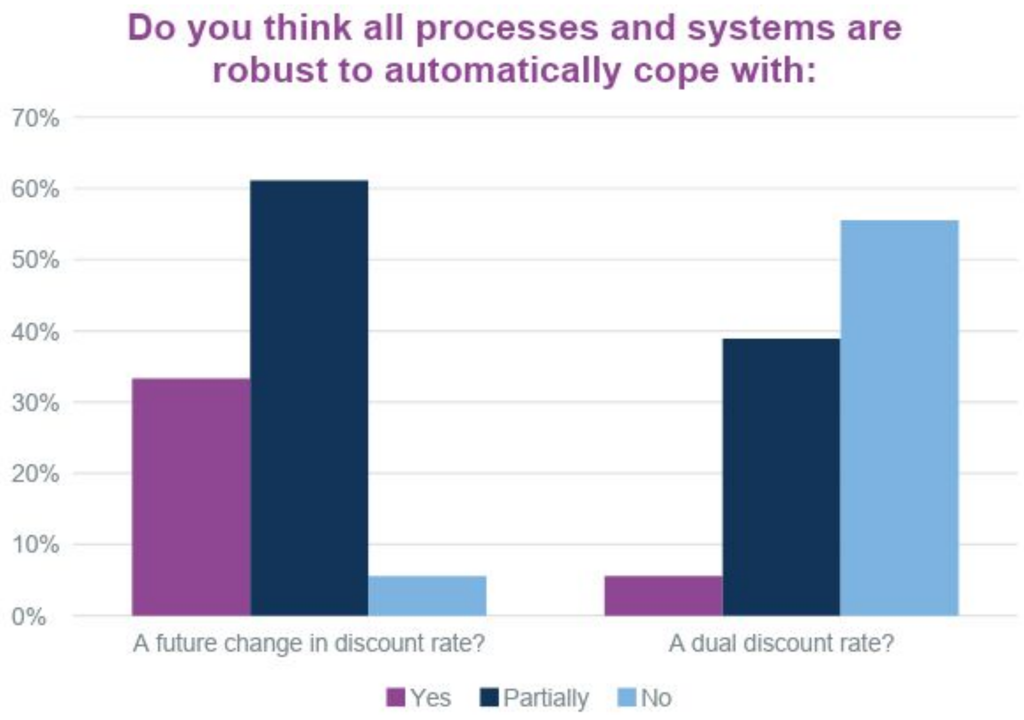
# (Re)Insurers feel well-equipped to deal with a new ODR but are far less prepared for a dual rate




- In line with last year's response **only 6%** of respondents stated that their processes and systems are not at least partially in a position to automatically cope with a future change in discount rate
- However over half of the respondents have systems and processes which would not be able to automatically cope with a dual discount rate at all and almost all others responded 'partially'

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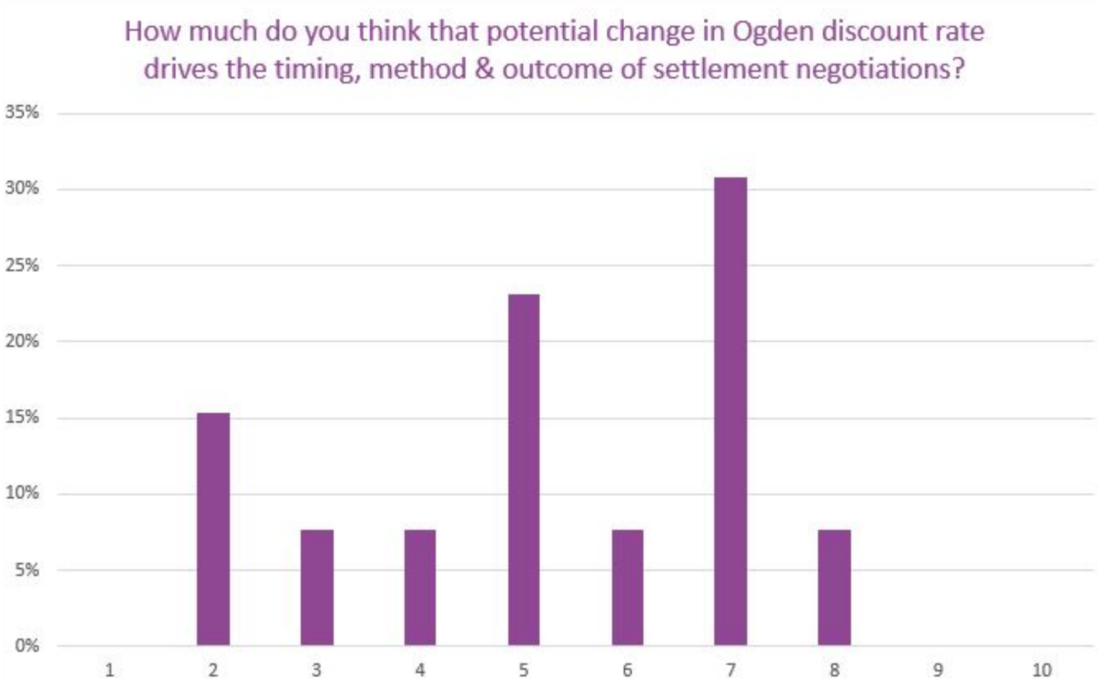
# No consensus on importance of ODR in settlement negotiations




(10 = the discount rate is a big driver while 1 = the discount is not at all a driver.)

- As was the case last year there is a wide range of opinions as to how big a driver a potential change in the ODR is to various aspects of settlement negotiations
- However no respondents selected the extremes of 1, 9 or 10
- **Only 14% of respondents** calculate the implied discount rate on settlement.

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# Slido

- https://www.slido.com
- **Code: 7026458**

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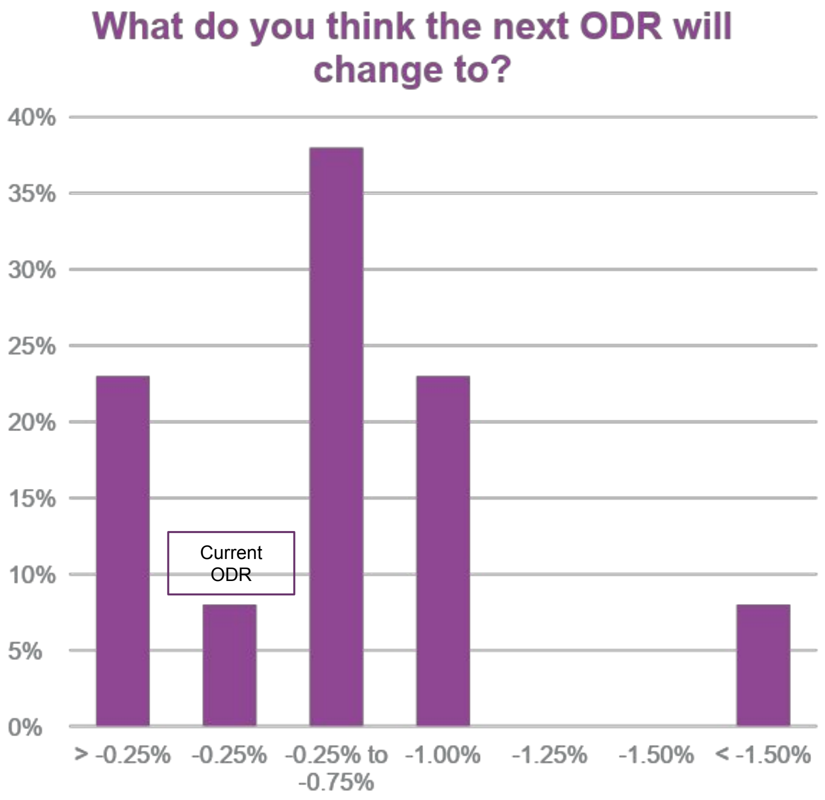
# Mixed views on what the next ODR will be




- There are mixed views on what the next ODR will be with most respondents believing it will be between -0.25% to -0.75%.
- 85% of respondents believe the ODR will change in Q2 2024
- There is a 50:50 split on whether respondents would prefer a dual rate

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# Any Questions on the Survey?

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# What would the ODR be now?

Francisco Sebastian

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# Setting the new Ogden discount rate

*Considerations*

Fairness to claimants

Single vs multiple rate(s)

Economic, inflation, financial forecasts

Investment portfolio – mix & duration

Tax and investment management costs

Consultation of a panel and the Lord Chancellor with different areas

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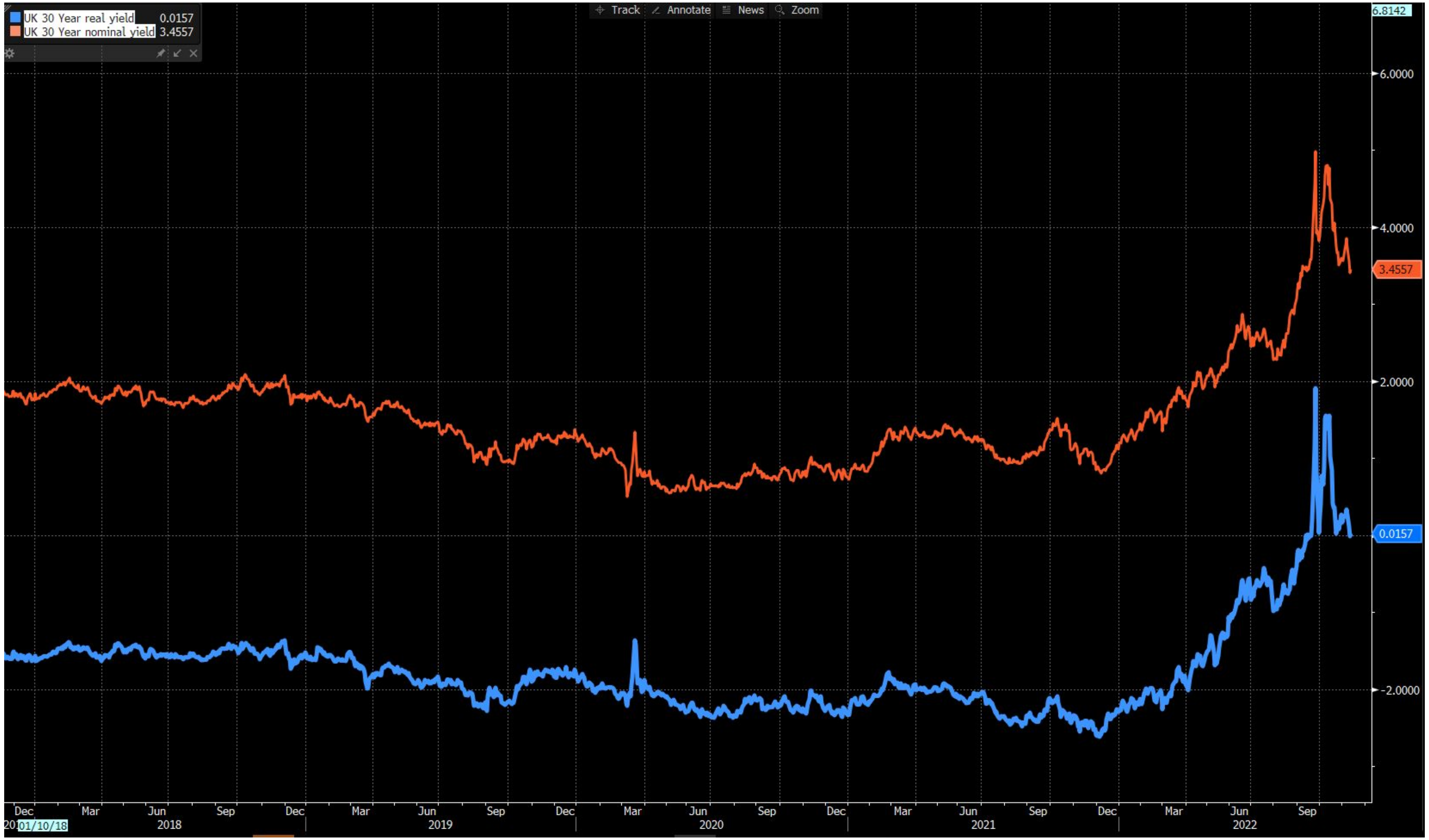
# Interest Rates




*Source: Bloomberg*

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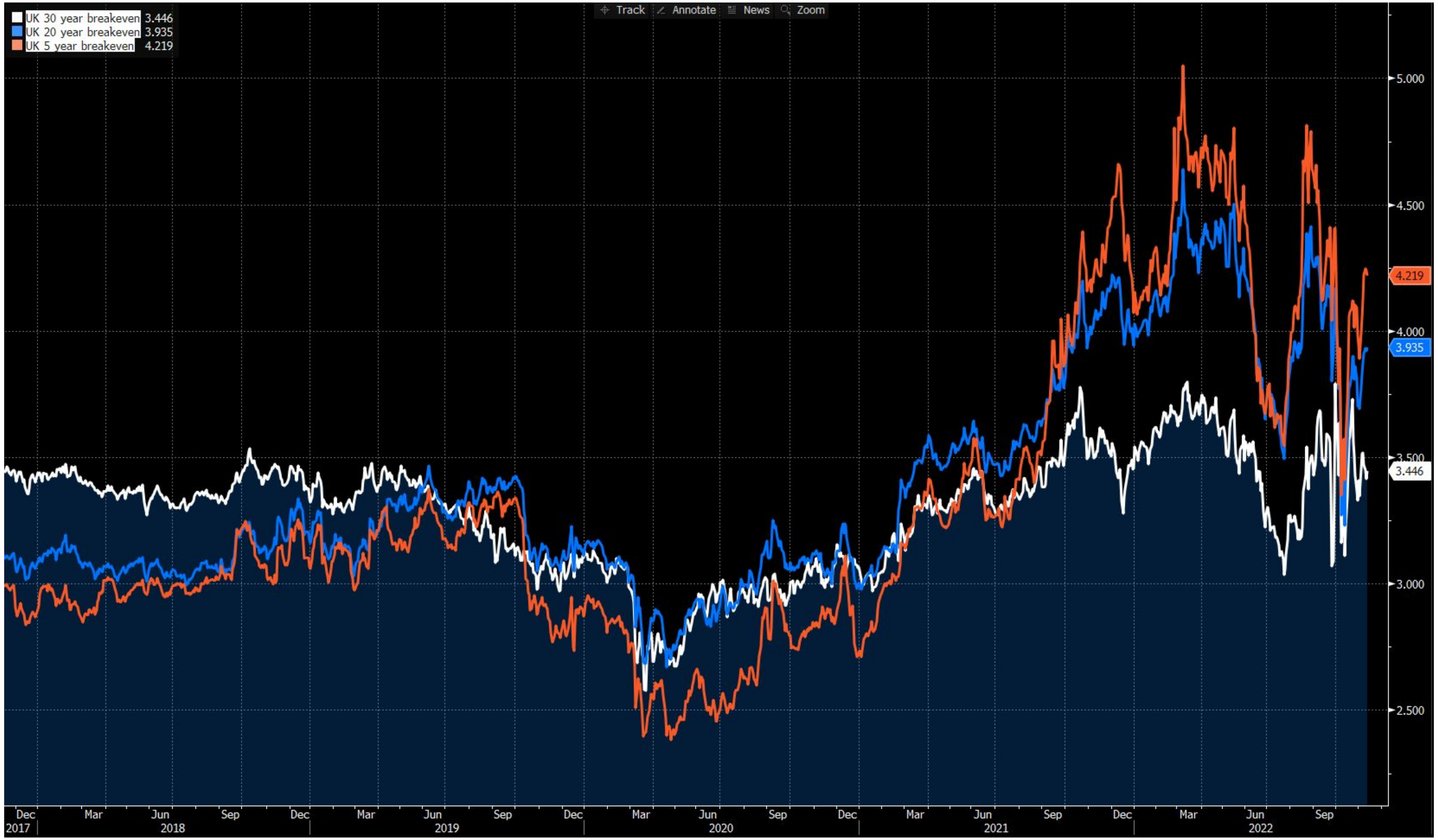
# Inflation expectations stubbornly above policy targets




*Source: Bloomberg*

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# What would the ODR be now in England and Wales?

| | GAD's conclusions | ODR WP Aug 2021 | ODR WP June 2022 | ODR WP October 2022 | ODR WP Nov 2022 (market inflation assumption) | ODR WP Nov 2022 (GAD original inflation assumption)[1] |
|---|---|---|---|---|---|---|
| Expected return | 4.00% | ↓ 3.50% | ↑ 4.75% | ↑ 6.30% | ↓ 6.00% | — 6.00% |
| Inflation (CPI) | -2.00% | -2.00% | ↑ -3.00% | ↑ -3.90% | ↓ -3.40% | ↓ -2.00% |
| **Real Expected Return** | **2.00%** | **1.50%** | **1.75%** | **2.40%** | **2.60%** | **4.00%** |
| Tax and Expenses | -0.75% | -0.75% | -0.75% | -0.75% | -0.75% | -0.75% |
| Damage inflation | -1.00% | -1.00% | -1.00% | -1.00% | -1.00% | -1.00% |
| **Return post DI, T&E** | **0.25%** | **-0.25%** | **0.00%** | **1.00%** | **0.85%** | **2.25%** |
| Political adjustment (extra margin) | -0.50% | -0.50% | -0.50% | -0.50% | -0.50% | -0.50% |
| **Ogden Discount Rate** | **-0.25%** | **-0.75%** | **-0.50%** | **0.50%** | **0.35%** | **1.75%** |

[1]This column has been included for illustrative purposes in order to most closely reflect GAD's methodology, and does not represent the working party's view of long term inflation

The differences are purely driven by the changing economic conditions.

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# High degree of uncertainty in the ODR estimates

- Current interest rate and inflation environment highly volatile
- Timing of the reviews in England & Wales, Scotland and Northern Ireland may therefore have a significant impact on the ODR
- Estimates by the working party also significantly impacted by the date on which they are performed

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# Conclusion

Andrew Corner
Mohammad Khan

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# Overall Conclusions

- Under the current methodology, a reasonable range for the ODR is between **-1% and +1.5%**
  - The timing of the calculation can affect results meaningfully
  - Long term inflation expectations are a key part of the calculation
- The current ODR methodology may be unstable under **volatile financial markets** and **inflation expectations**
- Most respondents to our survey believe the ODR will be between **-0.25% to -0.75%** at the time of the survey (August 2022).
- Higher proportion of respondents to our survey holding an allowance for a change in the ODR in **reserves** compared to **pricing** (37% vs. 23%)
- (Re)insurers who took part in our survey do **not** feel well equipped to deal with a **dual rate**

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# Next Steps

- Monitor any announcements on a change to the ODR
- Continue to refresh analysis of what the ODR would be
- Consider how to reserve in a dual rate environment

**Questions**

Comments

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# Thank you

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