Allianz

The Ogden discount rate change

To provide some context to the discount rate it's useful to consider an example. John is 30 years old and was seriously injured in a car accident. At the time of his accident he was earning £25,000 net per annum.

His injuries are so severe that he'll be unable to return to work and he will need nursing care for the rest of his life. The cost of the nursing needed is currently £75,000 per year.

John's claim is going to be settled by an insurer paying a single lump sum, which needs to reflect his future loss of earnings and the future cost of providing care.

John's future financial requirements are calculated by applying a multiplier to the present day calculation of John's financial needs (known as the multiplicand e.g. earnings net of tax and the cost of nursing care etc) with the aim of producing an accurate lump sum. The multiplier also takes into account mortality risks and most importantly, that the claimant will receive the lump sum up front and that it will be invested and earn interest.

The essential factor in arriving at the right figure is the appropriate rate of investment return on the capital sum paid in damages on settlement of the claim. This is the discount rate i.e. the amount by which a lump sum calculated as described earlier is discounted to allow for interest on the sum provided today. This ensures John gets the right amount of money for his needs.

The previous Ogden discount rate and how it works

The Ogden discount rate is set by the Lord Chancellor and it was last changed in 2001. The rate was previously set at +2.5%. The Odgen Tables list the multipliers which apply at the various discount rates across a range of -2% to +3% by age, gender of Claimant for both working life based on likely retirement age and for lifetime losses.

How the previous 2.5% rate applied to John's claim

The table below illustrates the multipliers for a 30 year old male depending on the discount rate applicable.

Multipliers for pecuniary loss of life (males)											
Age	-2%	-1.50%	-1%	-0.50%	0%	0.50%	1%	1.50%	2%	2.50%	3%
30	111.59	92.63	77.69	65.83	56.34	48.68	42.45	37.34	33.12	29.60	26.65
Multipliers for loss of earnings to pension age 65 (males)											
Age	-2%	-1.50%	-1%	-0.50%	0%	0.50%	1%	1.50%	2%	2.50%	3%
30	49.03	44.50	40.52	37.01	33.90	31.15	28.70	26.52	24.58	22.84	21.28

The multiplier for loss of earnings is **22.84*** and the lifetime multiplier is **29.60***. This means the future loss of earnings claim is calculated as £25,000 x 22.84 = **£571,000***.

The nursing care element of John's claim is calculated as £75,000 x 29.60 = **£2,220,000***.

Total damages for these elements of the claim therefore amount to **£2,791,000***.

* Calculation simplified to reflect raw data in the tables, i.e. excludes further adjustments.

The impact of the -0.75% rate change

The following shows how John's settlement would differ based on the new rate of -0.75% (figures taken from Rebmark Legal Solutions).

Multipliers for pecuniary loss of life (males)							Calculation
Age	-2%	-1.50%	-1%	-0.75%	-0.50%	0%	
30	111.59	92.63	77.69	71.43	65.83	56.34	£75,000 x 71.43 = £5,357,250
Multipliers for loss of earnings to pension age 65 (males)							
Age	-2%	-1.50%	-1%	-0.75%	-0.50%	0%	
30	49.03	44.50	40.52	38.71	37.01	33.90	£25,000 x 38.71 = £967,750

Adding these up for John's anticipated future lifetime (or future working lifetime for earnings) gives a settlement value for future loss of earnings and future cost of care of **£6.325m** – an increase in the amount the insurer will need to pay of **£3.534m** or 127%.

Consequences of the change

As you can see from John's example, the change in the Ogden discount rate from its current +2.5% to -0.75% reflects a significant increase in the total settlement of a claim. This will have a material impact on insurers' balance sheets and unfortunately means we need to reconsider the premiums we charge for private and commercial motor customers as well as those purchasing casualty, motor trade, and SME insurance products.