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The impact on future loss calculations for UK personal injury claims



CLYDE & CO

The calculation of personal injury awards is under the spotlight following news of the Lord Chancellor's proposed consultation on the discount rate applied to such awards.

In the UK, lump sum damages for future losses in severe injury claims, including loss of earnings and future care costs, are calculated by applying "multipliers" to the annual loss or cost.

The "multipliers" are discounted to take into account accelerated receipt, inflation and investment returns. However, case law (*Wells et al*) has established claimants should not be treated as ordinary investors and should not be expected to adopt risk. So the discount, widely known as "the discount rate", is based on investment returns from low-risk index-linked government stocks (ILGS).

In England and Wales, the discount rate is fixed by the Lord Chancellor using powers under the Damages Act 1996. The discount rate was set at 2.5% in 2001, based on the three-year rate of return on ILGS.

The methodology applied sparked a lot of debate, not all of it positive. Matters came to a head in the recent decision of the Privy Council in the Guernsey case *Helmot v Simon*.

The Damages Act does not apply in Guernsey. Instead, in *Helmot* the Privy Council upheld the Guernsey Court of Appeal's decision the discount rate should be calculated on a case-by-case basis, taking into account the average gross redemption yield of ILGS over a period of one year to the date of trial, with adjustments for tax etc.

For earnings-related losses, the Guernsey Court of Appeal went further, adjusting the yield for the excess of the rate of inflation of average earnings over the rate of price inflation.

This resulted in a discount rate

of 0.5% for non-earnings related losses and a rate of -1.5% for earnings-related losses.

So claimants are applying "negative multipliers" in jurisdictions where there is no equivalent to the provisions of the Damages Act. Further, since *Helmot*, all ILGS are producing negative yields. This means the discount rate is lower with the result that insurers are exposed to higher personal injury awards.

The effects of this have been felt in mainland UK. The Lord Chancellor's proposed consultation, with a view to resetting the discount rate, is the result of pressure from the mainland claimant lobby.

In exercising his statutory powers, the Lord Chancellor will take into account legal precedent, but he is also likely to be influenced by the government's own spending on personal injury claims, via the NHS Litigation Authority, Ministry of Defence and insurers.

A reduction from the existing 2.5% discount rate is expected.

Any change in the rate will have a significant impact on the insurance industry; lowering the rate will of course increase the level of lump sum awards.

Consequences for risk carriers will be threefold:

1. Insurers will need to increase reserves to provide for the higher awards;
2. As claims increase in value, recovery from reinsurers will increase, with the consequent impact on reinsurance renewal premiums and credit risk; and
3. Increases in claims value will inevitably be passed on to customers in the form of increased premiums.

Discussions continue to take place at industry, political, insurer and reinsurer level and we will continue to update you on developments. ■

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2.5%

Present discount rate applied to the calculation of personal injury awards