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National | Public Sector

Dealing with discount rate

Welcome to the February 2018 edition of Aon Inperspective

The Public Sector Bulletin

Staying in front of insurance related issues and trends affecting the public sector can be challenging. Aon Inperspective – the Public Sector Bulletin contains insight and news articles written exclusively by public sector experts and is designed to keep our clients and future clients ahead of the risk curve.

Alison Goodwin
Public Sector Director

Last February's announcement of a cut in the claims discount rate hit the public sector hard and, although draft legislation proposes an increase in the rate, there's still plenty of uncertainty in the market. Alison Goodwin, Director – Public Sector at Aon, outlines how organisations can mitigate the impact.

It's almost a year since the Lord Chancellor announced the claims discount rate was to be cut from 2.5% to minus 0.75%, resulting in significantly higher personal injury compensation payments. While government proposals will see the rate rise, as a date for this has yet to be set, there's still plenty of uncertainty in the insurance market.

The government's draft legislation was published last September, outlining how the rate should be set in the future. As well as proposing a rate review at least every three years, it also acknowledged that the rate should be set with reference to 'a low risk diversified portfolio' rather than 'very low risk investments such as index linked gilts'. Based on this shift, the revised rate is expected to be in the region of 0% to 1%.

Although this is good news for the insurance industry and other bodies that make personal injury compensation payments, the new rate will not be confirmed until the legislation is in place. While the Lord Chancellor said he expected this to happen in early 2018, with Brexit dominating the parliamentary timetable, it could take considerably longer.

Insurance reaction

Insurers have reacted by increasing rates on the classes of business affected – public liability, employers' liability and motor insurance. Unfortunately, due to the large number of high value injury claims that occur in the public sector, insurers in this market have been badly affected.

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Approaches to these rate increases have been varied, with some insurers setting them in line with the level of excess, while others have reviewed on a case by case basis. Disappointingly, where long term agreements are in place, at least one insurer has stated that this corrective action isn't a breach. Although we're sympathetic, we disagree with this view and would look to negotiate hard with the insurer wherever possible.

Mitigation strategy

With the discount rate revision up in the air, public sector organisations need to be aware of how this might affect them, their insurance and any claims that are settled during this period.

Firstly, it's important to assess your claims reserves. Although we've heard from some public sector lawyers that the proposed rate change is already being applied in some claims settlements, speak to your legal representatives to gauge their findings and make sure you have adequate funds set aside for the rate currently in force. Similarly, as it can take many years for some claims to settle, make sure you know what your exposure is.

As well as your liability, assess the proposals coming from your insurer. Some insurers state that they are already basing their calculations on the rate proposed in the draft legislation. Whether or not they've done this, check what will happen when the new rate does come into force as it should equate to lower claims payments and insurance premiums. It's also worth exploring how your insurer is reserving as this will also affect your overall premium.

But, while there's plenty of uncertainty, the proposed regime with its three yearly reviews and more realistic investment portfolio basis, should help to ensure the right balance is struck when it comes to compensating individuals.

For more information on the discount rate changes and how you can minimise the impact, please contact Alison Goodwin at alison.goodwin@aon.co.uk.