

## Limits of Indemnity

### Why £2 million may no longer be enough!

£2 million Public Liability has long been seen as the minimum level of cover for Public Liability insurance in the UK, however recent events have shown this may no longer be the case.

Put simply, Public Liability provides cover for loss or damage to Third Party Property or Person.

The Lord Chancellor has recently announced a reduction in the Ogden Discount rate from 2.5% to -0.75%.

### What is the Ogden Discount rate and what does this reduction mean?

The objective is to make sure a severely injured person has the necessary financial security to provide for their care and loss of earnings. The discount rate is used to calculate the amount of compensation they receive to reflect the return they will earn when that money is invested.

### Let's have a look at an example:

A 30 year old male was seriously injured in a motor accident. At the time of the accident his earnings were £25,000 per year.

His injuries mean that he will not be able to return to work and will need nursing care for the rest of his life. The cost of the nursing required is currently £75,000 per year.

The 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 his care.

The future financial requirements are calculated by applying a multiplier to the present day calculation of his financial needs (known as the multiplicand eg. 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 ie. the amount by which a lump sum, calculated as described earlier, is discounted to allow for interest on the sum provided today. This ensures the injured person gets the right amount of money for their 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 Ogden 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 would have applied to the claim

The table below illustrates the multipliers for a 30 year old male:

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	29.6	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	44.5	40.52	37.01	33.9	31.15	28.7	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 the 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 tables, ie. excludes further adjustments.

## The impact of the -0.75% rate change

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

Multipliers for pecuniary loss of life (males)

Age	-2%	-1.50%	-1%	-0.75%	-0.50%	0%
30	111.59	92.63	77.69	71.43	65.83	56.34

Multipliers for loss of earnings to pension age 65 (males)

Age	-2%	-1.50%	-1%	-0.75%	-0.50%	0%
30	49.03	44.5	40.52	38.71	37.01	33.9

Loss of earnings £25,000 x **38.71** = **£967,750**

Nursing care £75,000 x **71.43** = **£5,357,250**

Adding these up for the 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 increased amount the insurer will need to pay of **£3.534m** or 127%.

## Consequences of the change

As you can see from this example, the change in the Ogden discount rate from +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 insurers need to reconsider the premiums they charge for private and commercial motor customers as well as those purchasing liability, motor trade and SME products.