



BRIEFING PAPER

Number 06061, 18 October 2017

Motor car Insurance

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Inside:

1. Introduction
2. The insurance market and premium rates
3. The discount rate



Contents

Summary	3
1. Introduction	4
2. The insurance market and premium rates	5
2.1 Introduction: what causes premiums to rise?	5
2.2 Movements in motor insurance premiums	5
Cyclical market	5
Excess profits?	7
Insurance premium tax	8
Uninsured drivers	8
Bodily injury claims (whiplash)	8
Other fraud	15
2.3 A non-competitive market?	17
2.4 Government Action	18
3. The discount rate	23
3.1 The discount rate	23
3.2 The decision	24
Prior consultation	25
3.3 The impact	26
The insurance companies.	26
Individuals	27
3.4 The Review	27
3.5 New legislation	28

Summary

The market for motor insurance is seen by many as being dysfunctional. Premiums rise and fall sharply and unpredictably. Fraud against the industry is widespread but the relationship between the industry and car hire and repairers and legal claims firms seems equally dubious. For these reasons the industry has attracted the attention of public opinion, the competition authorities, and government and Parliamentary enquiries.

The industry, however, points out that the market is fiercely competitive, driven by price comparison websites, and is periodically unprofitable. Claims management companies deny that fraud is as prevalent as the industry suggests and that the 'compensation culture argument is exaggerated.

As a result of complaints about the sector, the Competition Commission investigated the market and concluded, in December 2013, that there were "features of the UK market for private motor insurance and related goods or services that, either alone or in combination, prevent, restrict or distort competition such that there are adverse effects on competition". Its successor body, The Competition & Markets Authority produced preliminary remedies in June 2014.

This Paper looks at some of the factors which influence the cost of motor insurance including the existence or not of a 'compensation culture', the impact of taxes on insurance and the potential future impact of the changes made to the 'discount rate'.

Another standard note [Small claims for personal injuries including whiplash](#) deals in detail with proposed reforms to the procedures involved with claiming compensation for soft injuries.

A Westminster Hall debate on the subject of the cost of insurance for young people was held on [20 March 2017](#).

1. Introduction

According to the Competition and Markets Authority Report in 2014 into private motor insurance (PMI):

At the end of 2012, there were around 26 million privately registered cars in the UK, representing about 75% of the vehicles registered in the UK. Insurance policies are underwritten by insurers. We estimated that the value of the gross written premium (GWP) for PMI was just over £10 billion in 2012, of which about 70% was accounted for by the ten largest motor insurers. The largest PMI provider is Direct Line Insurance Group. Insurance policies are sold through a number of different distribution channels. In 2012, the ten largest insurers sold over a third of their GWP direct by telephone or online, just under a third via brokers, and around a quarter via PCWs.¹

Over a significant period of time there have been a number of concerns about the market for car insurance. Periods in which premiums rose sharply are followed by periods of decline and later substantial rises. The industry expects there to be a new round of significant premium price rises.

The integrity of the market has also been questioned. Frauds upon the industry, either by 'crash for cash' claims or claims for soft body injuries (whiplash), are mirrored by extensive webs of interrelationships between the insurers and car hire firms, repairers and legal claims firms. These seem to be against the ethos of an open and competitive market and have attracted the attention of the competition authorities, government and Parliamentary enquiries.

The industry, however, points out that the market is fiercely competitive, driven by price comparison websites, and is periodically unprofitable. Claims management companies deny that fraud is as prevalent as the industry suggests and that the 'compensation culture argument is exaggerated.

It has been the periods of sharp premium increases which have prompted most public outcry. There appear to be three main reasons for the increase in motor insurance costs. First, premium rates tend to follow a cyclical pattern of several years of low rate increases followed by a catch-up. Second, increased levels of fraud against the insurers of which the increased incidence of claims for whiplash injuries is the most visible. Lastly the industry has had to absorb (or pass on) increasing rates of insurance premium tax set by government.

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This Paper looks at some of these factors.

¹ Competition & Markets Authority; [Private Motor Insurance: Final Report](#); September 2014.

2. The insurance market and premium rates

2.1 Introduction: what causes premiums to rise?

The cost of insuring a car depends on many factors. The most obvious are the age and experience of the driver (gender cannot now be used as a rating factor²), power and value of the vehicle and where the vehicle is kept or used. But other factors are at work too.

The market structure – competitiveness and the desire for profit in the market

Insurance premium tax rates

The number of claims and the cost in settling them including legal and repair costs

The prevalence of uninsured driving

Investment returns of insurers

The next sections look at some of these factors. At the outset it should be said that whilst some factors are easily quantifiable and uncontroversial, the impact of others and the scale of their impact, is far more controversial. Whiplash claims comes into this second category.

A Westminster Hall debate on the subject of the cost of insurance for young people was held on [20 March 2017](#).

2.2 Movements in motor insurance premiums

Cyclical market

A feature of the insurance industry is that it is very cyclical. Insurance is a product which is difficult to differentiate as between suppliers. To most drivers it is something you have to have in order to get on the road, the incidence of uninsured driving suggests that if there was no legislative requirement for insurance, many drivers would 'risk it'. Products that are sold not on the basis of their quality, but on the basis of price, are enormously sensitive to price changes and, hence, profits of the sector as a whole are highly volatile. The prevalence of the internet comparator websites has cemented this impact.³

Thus, premium rates do tend to follow a cycle in which years of very low increases as companies strive to be top of the best buy tables are followed by years when the market as a whole decides that it can no longer afford to charge loss making rates and a period of catch-up follows.

A table based on the motoring organisation AA's exercise of looking at insurance quotes for standardised risks available through comparison websites. This 'Shoparound Index' is an average of the five cheapest premiums for each risk. The intention is to most closely reflect the premiums most often paid by real motorists.

² See Library Paper: [Insurance and the sex discrimination laws](#)

³ It is also a feature of the insurance industry that there is no single set of statistics about 'the cost of insurance'. Most data is derived from surveys of the larger suppliers and is therefore

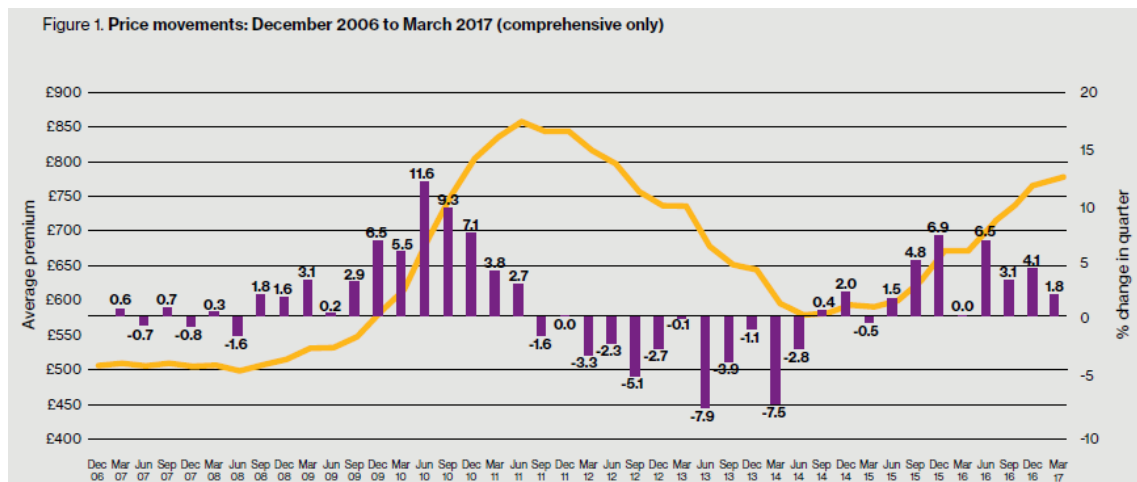
The table below shows clearly identifiable periods of sharp increases in premiums either side of a long run of premium price falls. The market appears to have recently passed through a catch-up phase – hence current concerns.

	Comprehensive		Third Party , fire & theft	
	Annual Change	Premium £'S	Annual Change	Premium £'S
2010 Q1		432.12		526.45
2011 Q1	42%	612.19	63%	859.01
2012 Q1	3%	627.56	5%	899.88
2013 Q1	-7%	586.03	-3%	876.40
2014 Q1	-16%	490.81	-18%	718.79
2015 Q1	-7%	457.78	-6%	672.96
2016 Q1	21%	552.45	14%	770.32
2017 Q1	16%	640.82	22%	941.26
Increase 2010 -2017	48%	208.7	79%	414.81

Source: AA-BIPI Shoparound survey; as @ April 2017

Over the whole period, inflation, as measured by the RPI increased by over 20% so premiums have risen in real terms. Premiums for third party fire and theft have risen more sharply, partly due to many insurers ceasing to offer cover on these terms.

A long run of figures compiled from a different source by Towers Watson and Confused.com shows graphically how the rate of change in rates varies⁴:



At a time when inflation generally has been at historically low levels, periods of sharp rises in premiums attracts considerable public and, latterly, parliamentary, interest from amongst other the Transport Select Committee. The cyclical nature of the market was referred to in evidence to the Committee when it first investigated the rise in premium rates in 2010. An insurance lawyer, Duncan Anderson said:

My view is that the increase we have recently seen had a little bit of catch-up. We've had relatively fast premium rate increases in 2007 and 2008. I think the recent increases we've seen are catching up. I think once the insurance market as a whole

⁴ Confused.com, [Car Insurance Price Index In association with Willis Towers Watson](#) – April 2017

7 Motor car Insurance

gets to a sustainable rate of premiums, if claims continue to increase at the rate they are currently increasing, the rates will continue to increase as well.⁵

Commenting on premium figures for the 3rd Q 2017, Confused.Com said that “Car insurance prices are £100 more expensive than a year ago, after accelerating by 14% over the past 12 months. UK drivers are now paying £838 on average for their car insurance”.⁶

Excess profits?

One thing the industry would argue is that premium rates have not produced super-profits, indeed no profits in many years as the table below shows.

UK MOTOR REVENUE ACCOUNT (ANNUAL BUSINESS) £millions

	Income	Expenditure			Underwriting profit/- loss	
	Net premiums	TOTAL of which:	Net claims incurred	Commission & expenses		Changes in provisions
TOTAL						
2005	10,397	10588	8425	2170	174	-191
2006	10,277	10481	8003	2253	226	-204
2007	10,634	10,878	8,239	2,418	222	-244
2008	10,831	11,301	8,738	2,567	-4	-471
2009	10,069	11,654	9,520	2,280	-146	-1585
2010	10,927	12,711	10,403	1,985	324	-1783
2011	12,178	12,522	9,679	2,317	527	-345
2012	11,729	12,016	9,375	2,622	20	-287
2013	11,309	11,329	8,736	2,726	-134	-19
2014	10,565	10,602	8,271	2,601	-270	-37
2015	10,366	10,333	7,815	2,527	-10	33
DOMESTIC						
2005	7,563	7,795	6,211	1,604	-21	-232
2006	7,491	7,939	6,179	1,653	107	-448
2007	7,912	8,287	6,316	1,756	216	-375
2008	8,146	8,713	6,802	1,900	11	-568
2009	7,727	9,215	7,542	1,742	-69	-1488
2010	8,344	9,982	8,302	1,425	254	-1638
2011	9,345	9,588	7,431	1,782	375	-243
2012	8,749	8,931	7,087	1,993	-149	-182
2013	8,407	8,402	6,473	2,070	-141	5
2014	7,830	7,858	5,991	1,908	-41	-29
2015	7,816	7,860	5,796	1,879	185	-44

Source: ABI

Premiums have risen over the medium term in real terms, but profitability in the market remains (apparently) elusive. What then has eaten into these premium rate rises?

⁵ [The cost of motor insurance](#); Transport Committee, Fourth Report, 2010-11, oral evidence, Q35

⁶ Confused .Com; [Car insurance price index Q3 2017](#)

Insurance premium tax

One easily identified factor which has affected the cost of motor insurance is the rise in insurance premium tax. Motor premiums attract the tax at the standard rate of tax, to be 12% from 2017. Previous rates are shown below:

Insurance premium tax	
Year	Rates
1993	2.5%
1997	4.0%
1999	5.0%
2011	6.0%
2015	9.5%
2016	10.0%
2017	12.0%

Source: Budget statements

With annual premiums averaging about £650 a year (see table below) the insurance element is roughly £70 a year.

Uninsured drivers

All motor insurers contribute to the Motor Insurers Bureau scheme which compensates individuals for personal injuries caused by untraced drivers or drivers with no insurance of their own. It is funded by levies from the industry – and ultimately – by premium income. According to the [MIB website](#) “In 10 years (since 2004) the estimated number of uninsured vehicles on UK roads has nearly halved to 1 million. This is due to a combination of enforcement and awareness campaigns”. There are distinct regional variations in the incidence of uninsured driving with London, Yorkshire & Humber and the East Midlands prominent amongst the worst offenders.

According to the Transport Committee’s Cost of Motor Insurance Report:

32. The Government has estimated that some 4% of motorists drive, illegally, without insurance. The Motor Insurers Bureau (MIB), which administers the scheme whereby motorists involved in accidents with uninsured drivers can pursue claims for damages, told us that this figure compared badly with other European countries. The MIB is funded by a levy on insurers, which increased from £39 million in 1991 to £417 million in 2008. As a result, uninsured driving adds around £30 to the average premium.⁷

If the MIB is right, and the incidence of uninsured driving has actually declined, and declined quite sharply, then this factor is not likely to have contributed to recent rate premium rises.

Bodily injury claims (whiplash)

Another main reason given for rising premium rates is the rise of bodily injury claims, in particular soft tissue ‘whiplash’ claims. This is a deeply controversial issue with parties taking very different positions. In brief government has accepted the industry view that many whiplash claims are either manufactured or at least exaggerated and encouraged by

⁷ [The cost of motor insurance](#); Transport Committee, Fourth Report, 2010-11

parties who make money out of settlements. Whereas legal and case management practitioners deny there is real evidence of fraud to support the view and regard the claims that measures to guard against it will lead to substantial falls in premiums unsubstantiated.

In trying to unravel this complicated argument this section will try to answer a few key questions.

- Are there more cars?
- Are there just more accidents?
- Are there an unusually high number of claims for soft body injuries as compared to the number of accidents? Are some regions of the country significantly more likely to make claims than others? Ditto countries. Is the UK more ‘whiplash’ prone than other countries?
- How much do the claims cost and is that cost rising?
- Is there evidence that individuals are more likely to make claims now than they did in the past?

Car numbers

- Road traffic increased in 2015. In 2014 there were 316.7 billion vehicle miles travelled in Great Britain. This is the highest level on record, and takes the total distance travelled back above the previous, pre-financial crisis 2007 peak.

Accident numbers

There is little evidence to suggest that a rising number of accidents is causing higher premiums.

- A total of 140,056 personal injury road traffic accidents were reported to the police in 2015. This is the second-lowest number in modern history, higher only than 2013. Source: DfT [Table RAS10002](#).

However, it is clear that there is a good deal of uncertainty as to the actual level of accidents that happen each year. Police records, shown in the right hand side of the table below are significantly lower than results from DfT survey evidence. That means that based on the DfT estimates approximately 3 to 4 slight injuries go unreported for every reported slight injury [Table RAS54004](#) the table below shows the central estimates over the last three five year periods:

Estimates of the annual non-fatal road casualties in Great Britain

Number (thousands, estimates rounded to nearest 10 thousand)

	Central estimate National Travel Survey			STATS19 Injured casualties (police records)		
	2009/13	2010/14	2011/15	2009/13	2010/14	2011/15
All road casualties	720	740	710	197	192	191
Adults	650	690	650	179	174	171
Children	70	60	70	18	18	17
Seriously injured	80	90	80	23	23	23
Slightly injured	640	650	630	178	173	168
Adult casualties:						
Car occupants	460	470	440	116	116	107

Department for Transport statistics

<https://www.gov.uk/government/publications/reported-road-casualties-great-britain-annual-report-2013>

Number and distribution of claims

If accident data is indecisive, claims data is similarly unhelpful. For example, the main source for statistics on whiplash claims is the Compensation Recovery Unit of the Department of Work and Pensions – all cases must be reported to it. It said, in response to an FOI request, that it cannot provide robust data. However, it had earlier provided figures for the Association of Personal Injury Lawyers (APIL). These figures are shown below:

Whiplash Claims as reported to Compensation Recovery Unit DWP	
Financial year	Number of claims
2010/11	511,111
2011/12	547,405
2012/13	488,281
2013/14	410,215
2014/15	376,513
2015/16	335,365

Source: CRU

It is equally hard to get reliable data on the cost of claims. The figures are private to companies or can be bought in aggregated form from the Association of British Insurers (ABI). A table of the cost of claims in a previous version of this paper is shown below:

Accident Year	Average cost of claims settled in each year of account (£)							
	2002	2003	2004	2005	2006	2007	2008	2009
2002	2,000	4,200	6,200	10,100	15,500	27,400	33,900	29,000
2003		2,500	4,200	6,500	10,700	17,900	26,600	31,600
2004			2,800	4,200	6,500	10,200	17,700	28,400
2005				2,700	4,100	6,400	10,700	19,700
2006					2,800	4,200	6,900	12,200
2007						2,800	4,600	7,900
2008							3,300	5,500
2009								4,000

Source: ABI

It is the bottom figure in each column which is the relevant one, showing that average costs for bodily injury claims doubled between 2002 and 2009.

Subsequent figures are available from 2013 from a Report by the Institute of Actuaries⁸:

⁸ Institute and Faculty of Actuaries, [2013 Research](#), November 2013

Motor-related personal injury claims		
	Number of settled claims	Average settlement cost £s
2012 *		8,400
2013	365,000	11,365
2014	342,000	10,738
2015	342,000	10,614

Source: ABI; *Institute of Actuaries

It is noteworthy that figures from both the CRU and the ABI show claims to be on a declining path. 2013 appears to have been something of a high-water mark for claims and costs and it was in 2103 when fundamental legal reforms were introduced by the *Legal Aid, Sentencing and Punishment of Offenders Act 2012*, which were aimed at cutting the cost of claims.

Regional variations

When the Transport Committee, in its 'whiplash' enquiry, took evidence across the industry, it found that there was a wide regional disparity in the rate of claims:

Q10 Chair: Dr Brown, from the actuary's point of view are we going to anticipate continually rising premiums?

Dr David Brown: I think it is more likely than not. The indicators of the inflation that has been seen and the costs of bodily injury have been fairly continuous, certainly over the last couple of years. Some of the work that we did in the Working Party did establish a link with the rise of claims management companies.

One of the interesting findings is the geographical correlation. There are particular areas of the country where there are a lot of claims management companies, particularly in the north-west. In other areas of the country there are fewer. High numbers of claims management companies do correlate with the high percentage of accidents with a bodily injury component in those areas. That was how we were able to establish a correlation between the rise of claims management companies and bodily injury [claims]⁹

According to the actuaries, in the 'hot-spots' (which includes the North West of the country) 40% of accidents have a bodily injury component, on average across the whole of the country it is 25% and where the claims management companies don't operate – Scotland – the figure is about 15%.

A report by a large insurance company – AXA - notes that the incidence of whiplash claims varies markedly across the country:

⁹ [The cost of motor insurance](#); Transport Committee, Fourth Report, 2010-11, oral evidence, Q35

AXA Whiplash Report 2011

Region	% of private motor insurance claims involving bodily injury
North West England	42.8%
North East England	40.3%
Yorkshire	37.4%
Central	30.5%
London and South East England (excl. Kent and Essex)	29.5%
Great Britain average	29.4%
Wales	28.3%
East Anglia	25.8%
West and South-West England	22.4%
Kent and Essex	21.8%
Scotland	20.4%
North-East Scotland	13.0%

Source: Actuaries Motor Third Party working Group

It is not obvious why one would be almost twice as likely to be injured in an accident in Devon than in Cumbria, or why slow moving London traffic has a third less accidents than equally slow moving traffic in other cities such as Liverpool. The report answers this with a specific reference to the prevalence of claims management companies regionally:

A positive correlation exists between the number of CMCs in a region and the proportion of private motor insurance claims that involve injury to third parties. Generally, more CMCs mean more motor insurance claims involving bodily injury. Prices of motor insurance are also linked to location of claims management companies. The North West of England has the highest average annual comprehensive premiums, at £1,615, as well as a very high concentration of claims management companies.¹⁰

Though why a claims company has, in this day of internet communication and reach, need to be physically in an area is not stated.

Whether the claims companies inflate claims, make claims where there wouldn't once have been claims or whether there is just less public tolerance for accepting injury is a debate that also went on in 2004.¹¹

Conclusions?

Despite what statistics exist, there seems to be no definite, single, statistical answer to why premiums have risen faster than inflation and are rising swiftly now.

Insurance companies are convinced that it is the claims companies and lawyers which are the root of all evil, whereas the legal profession deny that anything has changed over time and that the compensation culture is something of a myth. Arguments for the 'claims culture' focus on the fact that as one attendee at an insurance conference put it: "more people have developed a better understanding of their rights since the 1980s through to today".¹²

¹⁰ Transport Committee; [AXA Whiplash Report](#)

¹¹ P0410-34BTS

¹² Quoted in *Post Magazine* 12 August 2004, p12

13 Motor car Insurance

In November 2013, the Institute of Actuaries published research into the legal costs of 'small third party personal injury claims'. They found:

Despite a 15% drop in quoted premiums, the costs of insurance claims for private motor insurance rose by 7% in the last year; contributing to the expected £371 cost of a typical motor insurance premium

For every case involving a lawyer an average of £2,500 goes on legal fees for whiplash type claims

Whiplash-like claims account for 85% of the number of third party motor injury claims and just under half of the cost

Each small third party personal injury claim now costs insurers more than £10,000 on average to settle. For last year's data this figure stood at £8,400

The proportion of claim costs going to claimants has not increased since 2010¹³

On the other side of the argument though, the Association of Personal Injury Lawyers disputes the claim that there is a specific whiplash problem. It produced [The Whiplash Report 2012](#) to try to debunk what it sees as inaccurate conventional wisdom. The report's findings were based, in part, on a survey of 4,000 individuals carried out by an independent research body. The report's executive conclusions are shown below:

- Whiplash is not an epidemic. Only around one person in a hundred suffered a whiplash injury in the past year —
- Whiplash claims have fallen by almost 24,000 in the past twelve months —
- One in five whiplash sufferers suffer symptoms for more than a year —
- Almost 30 per cent of claims are encouraged by insurers —
- Almost 90 per cent of sufferers are diagnosed by a medical professional —
- 80 per cent of sufferers either report their symptoms accurately, or underplay their symptoms —
- Almost 40 per cent of sufferers do not claim compensation —
- 70 per cent of people would not want to pursue a whiplash claim without an independent solicitor¹⁴

The report points out that:

- the UK has more cars per kilometre of road than other European countries hence crowded roads makes low velocity minor accidents more likely;
- there are many more accidents than there are claims;
- insurance companies were as likely to encourage someone to claim, as lawyers and claims companies combined; and
- the public has an ambivalent attitude to what fraud is. For example only 90% of people think "claiming for an injury when you haven't been injured is fraudulent" and 89% think "deliberately crashing your car in order to be able to make a claim for personal injury is fraudulent". Hence if there is fraud the blame is shared.

However, one of the largest insurers, with a significant European presence, AXA, presented evidence to the Transport Committee which seems at odds with some of the claims made. It found:

¹³ Institute and Faculty of Actuaries, [2013 Research](#), November 2013

¹⁴ APIL; [The Whiplash Report 2102: Myth or Fact?](#)

Despite there being a significant reduction in traffic volume and road fatalities since 2000, there has been a 100% increase in the number of motor insurance injury claims over the same period. As a result, in 2011 UK motor insurers made an underwriting loss of £425 million;

One self-insuring company looked at in this study now has personal injury claims which account for 40% of all outstanding claims. This has increased by 13% in recent years. Another claimed to have average bodily injury claim costs of around £2,000, which is dwarfed by the potential £15,000–20,000 in legal costs that might be incurred in defending the claim;

Individual policies are getting more expensive. The cost of an annual comprehensive motor insurance policy rose by 102% between 1994 and 2011 impacted in no small part by the impact of whiplash claims, which now add approximately £90, or 20%, to each policy. This trend has been particularly damaging for young people, where 96% of young drivers now think they are being priced off of the road;

We can see in England and Wales how there has been a strong correlation between the number of claims management companies (CMC) and the number of bodily injury claims by region, a key driver in pushing up insurance premiums. The UK CMC industry grew significantly in 2010, with turnover increasing by 50% to £377 million;

A small element of the medical profession is also helping to drive up the level of personal injury claims. Again, this is particularly true in England and Wales where the diagnosis of whiplash is often reliant upon patient descriptions which can be inaccurate and easily falsified;

Whiplash now accounts for 75% of all personal injury claims in the UK which contrasts with just 3% in France where the diagnosis of whiplash requires objective proof based on more rigorous medical testing. No compensation can be awarded in France without an independent medical assessment by a professional who is an expert in dealing with bodily injuries;

Evidence gathered from the French insurance market shows how this outcome benefits consumers with a comparatively low cost of motor insurance compared to the UK, approximately 40% lower.¹⁵

The AA too has commissioned surveys of its members on their experience in relation to claims management companies:

Q.7 Despite measures to reduce the number of personal injury claim firms, there is no evidence that the number of claims for injuries such as whiplash, following a road traffic collision is falling. Which of the following best describes your own experience of personal injury claim firms within the past 12 months?	% of respondents
I have not been involved in a 'no fault accident' within the past 12 months but have been contacted by a firm encouraging me to claim for money owed to me.	58
I have been involved in a 'no fault accident' within the past 12 months and have been contacted by a firm encouraging me to claim for money owed to me.	5
I have been involved in a 'no fault accident' within the past 12 months and have not been contacted by a firm encouraging me to claim for money owed to me.	2
I have not been involved in a 'no fault accident' within the past 12 months and have not been contacted by a firm encouraging me to claim for money owed to me.	31

Source: AA Survey Poll November 2016

And:

¹⁵ Transport Committee; [AXA Whiplash Report](#)

Q.8 How many times would you estimate that you have been contacted by personal injury claim firms in the past 12 months?

Frequency of contacts	% of all respondents
1	5
2 - 4	34
5 - 9	25
10+	34
Don't know	3

Source: AA Survey Poll November 2016

<http://researchbriefings.intranet.parliament.uk/ResearchBriefing/Summary/SN04141>

The Library has produced a separate Paper on the proposed reforms to the legal claims system for soft injury claims: [Small claims for personal injuries including whiplash](#).

Other fraud

Whatever the cause of whiplash claims – genuine or fraudulent – the insurance industry is putting significant sums into trying to reduce this and other frauds. Some details about the extent of fraud were given in an article in the Financial Times linked to the industry contributing to policing costs:

Insurers are to spend £8.2m funding a specialist police unit that will be dedicated to cracking down on the growing problem of insurance fraud, which costs an estimated £2bn a year.

A new unit of 35 specialist fraud detectives and police support staff will be operated by the City of London police's economic crime directorate and will focus on opportunist fraudsters as well as organised criminal gangs who stage so-called cash-for-crash car accidents.

The new funding over three years comes from members of the Association of British Insurers at a time when the City of London Police is dealing with a 20 per cent cut to its Whitehall grant.

Adrian Leppard, its new commissioner, said earlier this year that the funding cuts "opened up an opportunity" for banks and other companies to step in and make a "further investment for their own interests" to help fight economic crime.

Mr Leppard told the Financial Times on Monday that he saw the latest funding as another important landmark for private sector funding in policing given the current financial climate.

He added that it paved the way for further specialist units, and potentially national economic crime units, to be funded by business. "It is a win for everyone, it secures jobs for people we might have lost and we can focus on particular types of fraud and organised crime involved in insurance fraud."

He said that insurance fraud added on average an extra £44 a year to each premium paid by consumers.

A strategic board including people from the ABI, City of London Police and Insurance Fraud Bureau will meet quarterly to set strategic priorities for the unit. However, the police will be entirely independent in deciding on investigations to pursue.

The new unit, which goes live next year, will work with the National Fraud Intelligence Bureau and the industry-funded Insurance Fraud Bureau.

Insurance fraud is on the increase. About 4 per cent of claims by cost in 2009 were fraudulent - similar to 2008 but twice the figure five years ago.

ABI figures show that 122,000 fraudulent claims worth £840m were uncovered in 2009, up 14 per cent on 2008. Motor insurance fraud was potentially most expensive at £410m. Household claims were most frequent at 62,000 cases.

Confirmation of the new unit comes just days after the ABI revealed that it was setting up an Insurance Fraud register to maintain details of known insurance fraudsters and identify anyone who fails to declare previous fraudulent claims.

The move by insurers is similar to the banking industry, which funds the Dedicated Cheque and Plastic Card Unit, which targets areas such as credit card fraud.

The unit is estimated to have saved about £370m for banks in the eight years since it was formed.¹⁶

In its response to the Transport Committee's Whiplash Report, the Government implicitly admitted that the quality of the data on fraud, particularly independent data, could be improved:

The Government does not centrally collect information on fraudulent or exaggerated personal injury claims and therefore may refer to data collated via industry sources. Such figures have not been verified by Government and when used are clearly marked as having been sourced from industry.

The Committee has requested an explanation of the Association of British Insurers' (ABI) data on the number of dishonest claims in 2013. This question is best answered by the industry, and we suggest the Committee writes to the ABI for a detailed answer.

However, for clarification the Government understands the process to be based on an ABI survey of its membership, which requests data in response to a list of scenarios in which it is believed fraud is likely to be involved. Members then provide the numbers of cases which fall into categories based on the Fraud Act 2006.¹⁷

The lawyers have pointed out that, in this same response, the ABI have admitted that the specialist police unit mentioned above has 'only' resulted in a few actual convictions:

In the last three years, the insurance industry has intensified efforts to combat fraud and protect its genuine customers. Since its inception in January 2012, the Insurance Fraud Enforcement Department (IFED), a bespoke unit housed within the City of London Police, has made 462 arrests, secured 84 convictions in court, and issued 139 cautions. It currently has around £29 million of fraud under investigation.

IFED has also coordinated two national 'days of action' in respect of 'ghost braking' and credit-hire fraud in which a total of 47 people were arrested. But it isn't just about enforcement. IFED takes every opportunity to use its high media profile to raise awareness of insurance fraud as an issue impacting honest customers that is not a victimless crime and to underpin the deterrent message.¹⁸

The ABI is keen to stress that it sees the unit and the publicity from prosecutions as having a powerful deterrent effect not recorded in the above figures. Summing up all the initiatives it says:

These initiatives send strong signals of the industry's ambition to reduce fraud and complement the excellent ongoing work of the IFB which has spearheaded the fight against organised insurance fraud since 2006, and is currently managing 109 investigations worth in the region of £120 million, the vast majority of which involve professional enablers.

¹⁶ *Insurers to fund police team in fraud crackdown*, FT 12 July 2011

¹⁷ Transport Committee; [Driving premiums down: fraud and the cost of motor insurance: Government and Association of British Insurers Responses to the Committee's First Report of Session 2014–15](#); HC 716,

¹⁸ Transport Committee; [Driving premiums down: fraud and the cost of motor insurance: Government and Association of British Insurers Responses to the Committee's First Report of Session 2014–15](#); HC 716,

The infrastructure and expertise are now in place across the industry, and there should be no let-up in identifying, deterring and enforcing against fraudulent activity.¹⁹

Evidence on fraud was also heard in the oral evidence session to the Transport Committee's report into the cost of motor insurance. This extract is from the AA representative:

Edmund King: Also alongside that (whiplash), there is fraud as well as part of personal injury: the so-called "cash for crash". Staged accidents are becoming more commonplace, where a car in front will stop suddenly and the car behind it hits it. There will be a witness there who is compliant with the people in the first car. They will then all make claims for whiplash. This is going on. It is helped by aggressive marketing by some of the personal injury management companies. Colleagues of mine at the AA who've had minor crashes two or three years ago have had telephone calls out of the blue suggesting that they may wish to make claims when they weren't even injured. This is obviously going on and this is pushing up premiums.

I think fraud is a major factor and, of course, with young drivers it is still about level of risk. Young drivers are 10 times more likely to have an accident in their first year than a 30 or 40-year old driver and therefore there is the likelihood of having that accident. Then there are the costs of the claims. If a young driver is scarred for life, it costs something like £3 million in insurance. If they are put in a wheelchair it might be £19 million. So there are large costs for the insurance companies. We do have to address how we can reduce the number of accidents involving young drivers. There is a lot around education and enforcement around that.²⁰

2.3 A non-competitive market?

Following concern over the rising cost of premiums the Competition Commission (now Competition and Markets Authority) launched an investigation into the sector in September 2012. It published its interim findings on 17 December 2013²¹ and further findings and recommendations were published in September 2014 as [Private motor insurance market investigation: Final Report](#). On two counts at least it found aspects of the market likely to contribute to higher than necessary premium rates.

The problems it discovered related first, to the chain of remedies involved in things like the repair of cars post claim:

We found that, in many post-accident non-fault claims, as a consequence of tort law, cost liability lies with the at-fault party in an accident whereas cost control lies with the non-fault party. This therefore leads to a separation of cost liability and cost control ('separation') in relation to most PMI claims (see paragraphs 26 to 42).³ We found that this separation, in combination with various practices and conduct, gave rise to inefficiencies in the supply chain for the provision of post-accident services to non-fault claimants. In our view, these features gave rise to an AEC as they distorted competition and caused higher transactional and frictional costs in the management of non-fault claims than would otherwise be the case. Ultimately this increased PMI premiums, especially for higher-risk drivers.²²

The manipulation of price comparison websites also came in for criticism:

We found that some of the contracts between PMI (private motor insurers) providers and price comparison websites (PCWs) contained conditions which limited price

¹⁹ Transport Committee; [Driving premiums down: fraud and the cost of motor insurance: Government and Association of British Insurers Responses to the Committee's First Report of Session 2014-15](#); HC 716

²⁰ [The cost of motor insurance](#); Transport Committee, Fourth Report, 2010-11, oral evidence, Q2

²¹ Competition Commission; [Private Motor Insurance Market Investigation: Notice of Provisional Findings](#); December 2013

²² Competition and Markets Authority, [Private motor insurance market investigation Final report](#); September 2014

competition and innovation, and could restrict entry (see paragraphs 53 to 63). We found that these 'wide' most-favoured nation (MFN) clauses, which restricted PMI providers' ability to set different prices on different sales channels, were a feature of the PCW market which limited competition, giving rise to an AEC [adverse effect on competition]. Ultimately, this led to higher PMI premiums. We decided to remedy this AEC by (a) prohibiting wide MFNs, and (b) prohibiting behaviours by large PCWs which seek to replicate the anticompetitive effects of wide MFNs.

However, there was little in the Report which focussed on traditional uncompetitive practices such as barriers to entry for new entrants or excessive market power of a few companies or simply too few companies in the market. Although there is a distinction to be made between 'brands' and companies, even the most casual use of one of the price comparison websites reveals a very large number of different insurance offers.

Material on reforms made to the justice system including changes to the small claims court are set out in another [Library paper](#).

2.4 Government Action

There is little which government can do directly to lower premium rises. Insurance is a private sector, commercial transaction, and the insurers are free to set their own rates. However, there has been interest in the subject of referral fees discovered by the Committee and by work done by former Justice Minister Jack Straw.

The Transport Committee Report quoted above drew attention to these as did Jack Straw MP as a result of his own research which discovered the 'secret' of the web of referrals. A recent exchange in the Lords takes up this point:

The Minister of State, Ministry of Justice (Lord McNally): My Lords, the Government are sympathetic to the idea of a ban on referral fees and are looking at how to tackle the issue as part of our wider reforms, and at how we could do so in a way that would be effective.

Lord Sheikh: My Lords, I thank my noble friend the Minister for that reply. Lord Justice Jackson's review of civil litigation costs prescribed a reduction in fixed costs and hourly rates for solicitors, as well as a ban on referral fees. Does the Minister agree with this position, and will he indicate whether the issue will be addressed in the Legal Aid, Sentencing and Punishment of Offenders Bill, which is currently in the House of Commons?

Lord McNally: Whether the question of referral fees will find its way into the Bill is a matter for the study that we are undertaking into ways that this could be implemented. However, we are trying to bring forward a range of the Jackson proposals in that Bill. As to referral fees, as my noble friend will be aware, the Legal Services Board and the Transport Select Committee advised a solution in terms of transparency. Lord Justice Jackson recommended a ban and, as I indicated, the Government are sympathetic to the idea of a ban.

Lord Carlile of Berriew: My Lords, in addition to that, will my noble friend confirm—as he indicated to me in a Written Answer to me on 23 June—that referral fees or kick-back fees in criminal cases are illegal, corrupt and should not be undertaken in any case by any lawyer?

Lord McNally: If that is what I said in a Written Answer it must be—[*Laughter.*] Even more so, it just sounds right.

Lord McFall of Alcluth: My Lords, the industry has called this its "dirty little secret". Given that over the past 10 years personal injury claim payouts have doubled from £7 billion to £14 billion while road accidents have largely reduced over that period, is this not a clear case of market failure, and the Government should report this to the OFT to look at this issue and get this industry sorted out?

Lord McNally: Whether it is a matter for the OFT or the regulator is a balance of judgment. The noble Lord is right that the figures are showing a doubling. One of the factors that one must look at is the unbelievable increase in whiplash claims, about which I know the Association of British Insurers has held talks with my colleague Jonathan Djanogly. It is far too easy to find in even the most minor of accidents that subsequently whiplash is claimed, along with quite substantial damages. One of the weaknesses in the system is that the insurance companies find it easier to settle and pass on the costs to the customer than to fight these bogus claims in the courts.

Lord Marks of Henley-on-Thames: My Lords, does my noble friend agree that this practice of insurers charging solicitors referral fees for names is not only unethical and offensive but ensures that the claims are handled not by the most competent or well qualified solicitors but by those who are prepared to pay the most to buy the clients—thus effectively depriving their clients of their right to choose the best lawyers to handle their cases? Is that not another good reason for implementing Lord Justice Jackson's recommendation for a ban on such fees?

Lord McNally: I agree with my noble friend. I hope that the more the public are aware of what the noble Lord described as this "dirty little secret", the more it is in the public domain and the more that all parts of the insurance industry, including the insurance companies, solicitors and the consumers, will demand—and we will respond to that demand—to ban it.

Lord Bach: My Lords, I am now slightly confused as to the Government's position on referral fees. I note what the noble Lord said in his written response to the noble Lord, Lord Carlile of Berriew, and what he said in his reply to the noble Lord, Lord Sheikh, today. Have the Government made up their mind to ban referral fees or have they not?

Lord McNally: I am only surprised that someone with such long experience as a Minister should leap on this as if I were dodging the question.

Noble Lords: Oh!

Lord McNally: I can see a few more experienced ex-Ministers over there. The Government are sympathetic to the idea of a ban on referral fees, and are looking at how to tackle the issue as part of wider reforms—how we could do so effectively. Perhaps the Opposition have not yet got used to the fact that we are not a knee-jerk reaction Government; we are looking at the problem. The Prime Minister himself has made it very clear that we believe that Lord Justice Jackson has given us the solution to the problem. We are now looking at how to make it most effective.²³

Mention has been made above of the Transport Select Committee's interest in the subject. The [Government's response](#) to its report was published on 17 April 2012.²⁴

In October 2013 the Government published a combined [White Paper](#) and response to the Transport Committee on whiplash.²⁵ It focussed on

- better medical evidence;
- action to challenge fraudulent or exaggerated claims;
- reforms to the small claims track threshold; and
- data sharing of whiplash claims.

The forward to the Report summarised government action to date (see below) and continued by outlining the specific whiplash measures:

First, the Government wishes to press ahead with our consultation proposal to introduce independent medical panels, backed up by an accreditation scheme, to establish a new more robust system of medical reporting and scrutiny. This should mean that exaggerated and fraudulent whiplash claims are challenged whilst ensuring

²³ HL Deb 7 July 2011 c350-1

²⁴ Government Response to the Committee's Twelfth Report, HC 1934 2010-12

²⁵ Reducing the number and cost of whiplash claims; CM 8738, October 2013

that the genuinely injured, backed up by good quality medical evidence, can get the help and compensation they deserve. We want to work with all sides, including insurers and claimants, to develop a comprehensive, effective and proportionate system of independent medical panels. We are grateful to representatives from all sides of the industry for their early constructive proposals in this area.

We also want to work with all sides to tackle together those practices which can contribute to the inflated number of whiplash claims. For example, we want insurers to end the practice of making offers to settle claims without requiring medical reports. We also want insurers to share more of their data on suspected fraudulent or exaggerated claims with claimant lawyers, and we want claimant lawyers to carry out more effective checks on their potential clients before taking on claims.

On the consultation options to increase the Small Claims track threshold, the Government has carefully considered responses. We believe that there are good arguments for increasing the Small Claims track to £5000 for all road traffic accidents to raise incentives to challenge fraudulent or exaggerated insurance claims. At the same time, we have listened to the views of the Transport Committee and others that now may not be the right time to raise the Small Claims limit because of the risks that it may deter access to justice for the genuinely injured and encourage the growth of those disreputable claims firms which so damage the industry. At this stage, we have decided to defer any increase in the Small Claims track until we can determine the impact of our wider reforms on motor insurance premiums and better safeguard against the risks identified above. We believe that this is the right thing to do for all parts of our society.²⁶

A range of further multi-issue measures were announced by the Ministry of Justice in June 2014. Not all of the measures were motor insurance specific but will have some application to it. The relevant press release is shown below:

A new package of measures to tackle insurance fraudsters and dishonest claims has been announced which will reduce the amount being paid out unnecessarily by insurance companies on fraudulent claims and enable them to pass on savings to honest customers. These will affect bogus claims, both motor claims and others such as 'trips and slips' at work and in public places.

They include:

requiring courts to throw out compensation applications in full where the claimant has been fundamentally dishonest – to stop people who have had an accident from exploiting the system by making bogus claims or grossly exaggerating the extent of their injuries

plans to ban lawyers from encouraging people to make claims by offering them incentives like cash or iPads

reducing questionable whiplash claims by improving medical assessments, ensuring they are only conducted by independent accredited professionals, and setting fixed fees for medical reports this year

introducing new rules this year to restrict the practice of settling whiplash claims without confirmation of the claimant's injury²⁷

The first two measures were introduced by Part 3 of the [Criminal Justices & Courts Act 2015](#). The last two measures will be new court rules due to be in force by October 2014.

The press release included an updated list of 'what the Government has done' to try and influence insurance premiums from the October 2013 White Paper (see above). The combined list is shown below:

²⁶ Ibid p6

²⁷ MOJ [Press release](#) 7 June 2014

- Reduced by more than half the fees lawyers can charge insurers for processing basic, uncontested claims for compensation for minor injuries suffered in road accidents – from £1,200 to £500
- a ban on referral fees paid between lawyers, insurers, claims firms, garages and others for profitable claims, by implementing Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012;
- the Claims Portal, used by lawyers and insurers to settle payouts for road accidents quickly and simply, has been extended to cover claims up to the value of £25,000 and now extends beyond road traffic accidents to claims for accidents at work and in public places;
- increased the fixed penalty for driving without insurance from £200 to £300; and since introducing Continuous Insurance Enforcement in 2011, making it illegal to own an uninsured vehicle unless it has a registered statutory off road notification, the number of vehicles without insurance has fallen from 1.4m in 2010 to 1.2m in 2012.
- Banned claims management companies from offering cash incentives or gifts to people who bring them claims. Recommend a friend deals also banned, along with contracts agreed only over the phone
- Changed the law so that regulated companies which breach Claims Management Regulation Unit rules can be fined (as well as the existing sanctions of being suspended or closed down). We have recently consulted on the level of the fines – which are proposed at up to 20 per cent of the annual turnover of companies - for offences including using information gathered by unsolicited calls and texts, providing bad services or wasting time and money by making spurious or unsubstantiated claims. This will mean fines of hundreds of thousands of pounds, and potentially millions in some cases²⁸

The issue was returned to by the Transport Select Committee in a further Report: [Driving Premiums down: fraud and the cost of motor insurance](#).²⁹ It recommended:

28. We are in no doubt that fraudulent and exaggerated claims have been encouraged by the insurers' practice of paying out for whiplash claims without requiring a medical examination. We strongly agree with the Government's intention to prohibit such offers, as part of the new system for independent medical panels for diagnosis and reporting.

The Government's support for the general proposition of reform was furthered by a statement in the 2015 Autumn Statement which said:

Lower motor insurance costs

1.143 The government is determined to crack down on the fraud and claims culture in motor insurance. Whiplash claims cost the country £2 billion a year, an average of £90 per motor insurance policy, which is out of all proportion to any genuine injury suffered.⁶¹ **The government intends to introduce measures to end the right to cash compensation for minor whiplash injuries, and will consult on the details in the New Year.⁶² This will end the cycle in which responsible motorists pay higher premiums to cover false claims by others. It will remove over £1 billion from the cost of providing motor insurance and the government expects the insurance industry to pass an average saving of £40 to £50 per motor insurance policy on to consumers.**

²⁸ Ibid

²⁹ Transport Committee, [Driving Premiums down: fraud and the cost of motor insurance](#), Fourth Report, HC 285; 2014-15

The other proposed reform is to raise the threshold for claims for 'minor soft tissue injuries' from £1,000 to £5,000 so that more claims can be processed without CMCs. The ABI (insurers) is very much in favour of the initiative. It said:

This is a significant breakthrough in tackling the compensation culture and is good news for motorists. Insurers have long called for meaningful reform in reducing costs in the compensation system, including increasing the Small Claims Track Limit. Previous Government reforms have already led to insurers passing on over £1 billion in savings to motorists through lower premiums, and in a highly competitive motor insurance market, insurers will continue to pass on savings to customers.

There is no detail about what is proposed but there have been moves in the industry to focus help on rehabilitation, so that claimants get medical advice and help, possibly paid physio, instead. Fraudsters are assumed not to keep wanting to go to a hospital instead of spending cash compensation.

In the immediate aftermath of the announcement the BBC produced this quote from a social media source:

Insurance firm Aviva has said that changes in the Autumn Statement to the way people can claim compensation for whiplash could knock between £40 and £50 per year off motor insurance premiums.

Alongside the work of the Committee and the Government's support for their position, two further pieces of legislation were passed.

Other measures

Referral fees were abolished by virtue of the [Legal Aid Sentencing and Punishment of Offenders Act 2012](#), which came into force in April 2013. The new provisions will prohibit the payment and receipt of referral fees by making it a regulatory offence (rather than a criminal offence) to pay or receive referral fees, in specified types of legal business. The ban will apply to regulated persons including solicitors, barristers, and claims management companies, and to insurers. Full details of this reform are set out in another standard note (SN/HA/6015).

Fraudulent claims were addressed in the [Insurance Act 2015](#). The Act gives new statutory remedies for insurers if a policyholder has submitted a fraudulent claim, namely if a claim is tainted by fraud, the policyholder forfeits the whole claim.

3. The discount rate

In February 2017, an announcement from the Ministry of Justice provoked the insurance industry to claim that premiums would rise by £70. The share price of the Admiral Group was down 8% at one stage and Direct Line fell by more than 7%. The cause of this was an announcement about a change to the discount rate.

Box 1: General Election 2017

The sudden calling of a General Election in April 2017 has meant that some pieces of legislation could not finish their Parliamentary stages. The legislation to give effect to the new discount rate – the Prisons and Courts Bill - was one such casualty. It is not known how the next government will proceed.

3.1 The discount rate

A fundamental principle of insurance is that insurance only provides compensation for an event – loss, injury, etc. and that the amount paid should not exceed the loss. Perverse disincentives might arise if insured people got more for an incident than they had lost.

In motor insurance this principle often gives rise to the unpopular situation where the insurer 'writes off' a crashed vehicle if the cost of repair exceeds the cost of buying a similar vehicle.

In cases of compensation for long term disability due to an accident, the total compensation – paid as a lump sum up front – is subject to an investment test. The agreed annual compensation, multiplied by the likely period produces a total compensation figure. However, a lump sum paid now, can be invested to produce a stream of income returns over that period, hence, the actual lump sum needed *now* is reduced by the likely investment returns over the period.

In accounting terms the compensation is the net present value of the future income streams including profits and interest. The interest rate assumed in this exercise is called the discount rate. The rate is set by statute by virtue of Section 1 of the [Damages Act 1996](#). Section 1 states:

Assumed rate of return on investment of damages.

(1) In determining the return to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury the court shall, subject to and in accordance with rules of court made for the purposes of this section, take into account such rate of return (if any) as may from time to time be prescribed by an order made by the Lord Chancellor.

(2) Subsection (1) above shall not however prevent the court taking a different rate of return into account if any party to the proceedings shows that it is more appropriate in the case in question.

(3) An order under subsection (1) above may prescribe different rates of return for different classes of case.

(4) Before making an order under subsection (1) above the Lord Chancellor shall consult the Government Actuary and the Treasury; and any order under that subsection shall be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.

If the discount rate is high, the initial lump sum will be heavily discounted because the victim is assumed to be able to earn a lot from the capital sum through investing it. A lower discount rate implies lower investment returns, so the initial lump sum must be higher. In February 2016 the Justice Secretary announced that the discount rate would be reduced from 2.5% to -0.7%. Since insurers only pay out the discounted compensation figure and premiums are set to meet likely claims, a lower discount rate inevitably means higher pay outs and, one expects, higher premiums to meet them.

3.2 The decision

Because of its market sensitivity the official announcement about the decision was made first to the Stock Exchange. The regulatory notice is shown in full below:

Under the Damages Act 1996, I, as Lord Chancellor, have the power to set a discount rate which courts must consider when awarding compensation for future financial losses in the form of a lump sum in personal injury cases.

The current legal framework makes clear that claimants must be treated as risk averse investors, reflecting the fact that they may be financially dependent on this lump sum, often for long periods or the duration of their life.

The discount rate was last set in 2001, when the then-Lord Chancellor, Lord Irvine of Lairg, set the rate at 2.5%. This was based on a three year average of real yields on Index Linked Gilts. Since 2001, the real yields on Index Linked Gilts has fallen, so I have decided to take action.

Having completed the process of statutory consultation, I am satisfied that the rate should be based on a three year average of real returns on Index Linked Gilts. Therefore I am setting it at minus 0.75%. A full statement of reasons, explaining how I have decided upon this rate, will be placed in the Libraries of both Houses of Parliament. The Statutory Instrument to effect this change will be laid today, and will become effective on 20 March 2017.

There will clearly be significant implications across the public and private sector. The Government has committed to ensuring that the NHS Litigation Authority has appropriate funding to cover changes to hospitals' clinical negligence costs. The Department of Health will also work closely with General Practitioners (GPs) and Medical Defence Organisations to ensure that appropriate funding is available to meet additional costs to GPs, recognising the crucial role they play in the delivery of NHS care.

The Government will review the framework under which I have set the rate today to ensure that it remains fit for purpose in the future. I will bring forward a consultation before Easter that will consider options for reform including: whether the rate should in future be set by an independent body; whether more frequent reviews would improve predictability and certainty for all parties; and whether the methodology - which in effect assumes that claimants would invest only in index-linked gilts - is appropriate for the future. Following the consultation, which will consider whether there is a better or fairer framework for claimants and defendants, the Government will bring forward any necessary legislation at an early stage.

I recognise the impacts this decision will have on the insurance industry. My Rt. Hon. Friend the Chancellor will meet with insurance industry representatives to discuss the situation.³⁰

The decision was not entirely unexpected in the sense that market conditions – especially market interest rates have altered significantly since the last review and change in 2001. The historically low rates of interest ever since the financial crisis are now seriously out of line with a 2.5% investment return in non-risky assets.

³⁰ [Stock Exchange Regulatory Notice 8872X](#); 27 February 2017

It is also not unexpected given that there has been a lengthy consultation period which looked at how the rate should be calculated. The Association of British Insurers (ABI) described this here:

The process of reviewing the discount rate and the methodology in setting it began of course in August 2012, after a review had first been announced in November 2010. In August 2014 it was revealed that a panel of experts was to be appointed to prepare a report giving expert investment advice to assist with the review but the panel only began its considerations in March 2015. It is known that the experts have reported to the MoJ but the report is yet to be published. In a separate exercise that started in the summer, the analytical services team of the MoJ has been carrying out research to improve the quality of advice to Ministers on the impact of any change in the rate.³¹

Further, the Justice Minister announced, in January 2017 again via a Stock Exchange statement, that she was “undertaking to review the discount rate for personal injury damages awards, and to announce the result of the review by 31 January 2017”.

Prior consultation

The consultation document referred to can be found here: [Damages Act 1996: The Discount Rate Review of the Legal Framework](#). It should be noted that this was a consultation in how the rate should be calculated, rather than should the rate be changed under the existing rules.

The consultation looked at whether the underlying assumption of a risk-averse investment approach should be modified, so that the rate can be set by reference to higher risk investments, which could produce a higher discount rate and thus lower lump sum awards (and premiums) than under the present law. Secondly, given the potential problems calculating the long term adequacy of lump sum awards (getting the sums right) the consultation looked at whether there was a case for encouraging the use of periodical payments. The paper notes:

This second issue will be primarily examined in the context of the law of England and Wales and Northern Ireland only. For Scotland, consideration of this issue is limited to the extent that a periodical payment order may be made but only with the consent of the parties involved.³²

It goes on to explain how practice has diverged from the legal theory and the consequences arising from this:

At present the discount rate is set by reference to the expected rates of return on certain types of safe investments. However, there is evidence that recipients of these lump sums do not invest in the cautious way that is envisaged by the guidelines. Instead, the initial evidence indicates, they seem to invest in mixed portfolios, including higher risk investments. This may be the result of a number of factors, but it might suggest that the current legal parameters for setting the rate may produce a rate that is too low. This would result in over-compensation for claimants and extra cost for defendants and those who fund them. These unnecessary costs could unfairly increase the burden on taxpayers and consumers as ultimately they have to fund the payments by state bodies and private insurers. Conversely, if the rate is too high, it is the victims of wrongful personal injury who will suffer.

The inherent uncertainty as to whether a lump sum award will fully compensate the injured person’s losses, which is at least partly attributable to the application of a discount rate, can, however, be avoided because compensation can be taken wholly or partly in the form of periodical payments to meet the losses as they arise. These payments clearly have to be funded and come with their own advantages and

³¹ [ABI website](#) 8 December 2016

³² [Damages Act 1996: The Discount Rate Review of the Legal Framework](#)

disadvantages but they do avoid problems attributable to the application of a discount rate.³³

3.3 The impact

There are two impacts to consider. First that on the insurers and secondly on the insured.

The insurance companies.

The main impact immediately reported was the impact on profits and on the solvency of the companies. Material market developments have to be notified to the Stock Exchange from where the following are drawn.

Direct Line

The Group expects to recognise the New Discount Rate in its financial statements and also within its Solvency 2 ratio calculation for the year ended 31 December 2016. The Group has previously disclosed in its 2015 Annual Report that its claims liabilities, at that time, were calculated using a discount rate of 1.5%.

The Group currently estimates that the impact of moving to the New Discount Rate of -0.75% on the 2016 reported financials would be to:

reduce profit before tax by between £215 million and £230 million after reinsurance recoveries (including the impact on both ongoing and run-off business);

increase the Combined Operating Ratio ("COR") for ongoing business by approximately 6ppts; and

reduce the Group's year end Solvency II capital coverage ratio before dividends, to towards the higher end of the Group's target range of 140-180%. As at 30 June 2016, the Group's Solvency II coverage ratio was 184% after interim dividends.³⁴

Esure Group

As at 31 December 2016, the Group's reserve margin included an allowance of £2m (net) for a change in the Ogden discount rate to 0%. The discount rate announced today was lower than the Group had allowed for as at 31 December 2016 and subsequently the Group will see **a further net impact of £1m in 2017**. The Group continues to expect its combined operating ratio for 2016 to be within its original guidance of 98-99%.

As at 31 December 2016, the Group's solvency coverage above its solvency capital requirement ("SCR") included an allowance of £3m for a change in the Ogden discount rate to 0%. As a consequence of the discount rate moving to minus 0.75%, **the Group's capital position in 2017 will be impacted by £2m**. The Group's 2016 solvency position will be in the upper half of its stated risk appetite (130-150% coverage of its SCR).

Admiral Group

In order for the impact of the new rate to be reflected in the Company's 2016 results, Admiral has **decided to postpone the preliminary announcement of the results** for the year ended 31 December 2016 from 1 March 2017 to 8 March 2017.

The reduction in the discount rate will have the effect of increasing the cost of personal injury claims, therefore also increasing the ultimate loss ratio for all business written up to the effective date, part of which will be earned and part unearned. The majority of the financial impact in respect of premiums earned during 2016 and prior years will be reflected as a one-off charge against 2016 second half profits. The balance (along with the impact on business written but unearned at the date of change) will be recognised as lower reserve releases and profit commission mainly over the subsequent three to five financial years as the affected claims settle.

³³ [Damages Act 1996: The Discount Rate Review of the Legal Framework](#)

³⁴ [Stock Exchange Regulatory Notice](#); 27 February 2017

The estimated total net financial impact of all claims settling at the new rate is £140m to £175m. The estimated net financial impact on 2016 reported profit is £70m to £100m.

It is worth noting that insurers had already taken some steps to 'hedge' an adverse decision, either by internally operating a lower discount, or by putting aside more reserves.

Whilst the ABI described the decision to cut the discount rate as 'crazy', the Association of Personal Injury Lawyers, welcomed the decision and said in a statement that "people already coping with the most severe injuries have been deprived of the help and care they need for years".³⁵

Individuals

The strong expectation was that premiums would rise. The decision came into effect on 20 March 2017. It is likely, if there are no further changes to the way the rate is calculated, that the biggest impact will be on those groups who one might reasonably expect to receive compensation covering the longest period of time. Logic suggest that this group would disproportionately include younger drivers. Young drivers have more accidents and, in cases where they suffer permanent disabilities rather than death, an award has potentially to cover 50 years or more. Improvements to car safety have significantly reduced the likelihood of death in an accident, but often only at the cost of a lifetime requiring care.

Because the impact is likely to be felt differently across the insured population, it is difficult to estimate what the impact will be on particular groups. Comment in the press includes the claim that for young people "annual premiums could rise by up to £1,000" and "Drivers aged over 65 could also face an extra £300 charge, while the average comprehensive motor insurance policy could increase by up to £75 a year"³⁶ and "Consultants PwC estimated annual motor premiums would rise by £50- £75 on average".³⁷

Because of the scale of the potential impact it was certain that the decision, and the way that it was taken would be reviewed.

3.4 The Review

The industry response to the decision was very forceful. A change in the discount rate had been expected, but the decision to move it to a negative rate was wholly unexpected.

The ABI requested a meeting with the Chancellor the day after the announcement was made. They issued a joint statement after:

"Claimants must get the money they're entitled to following an injury in order to support their future needs. "It is important that going forward, personal injury discount rates are set at a level that is fair to both claimants and consumers. "The government will progress **urgently with a consultation on the framework for setting future rates**, and bring forward any necessary legislation at an early stage. "The industry will contribute fully to the upcoming consultation, and the government will carefully consider all evidence and arguments submitted."³⁸

The MoJ consultation referred to was [published in March 2017](#). It looked at:

- What principles should guide how the rate is set?

³⁵ [Reuters 27 February 2017](#)

³⁶ Daily Telegraph online 27 February 2017

³⁷ [Reuters 27 February 2017](#)

³⁸ [ABI press release](#) 28 February 2017

- How often should the rate be set?
- Who should set the discount rate?

The paper also considered whether sufficient use is being made of periodical payment orders.

The Response to the Consultation was published in [September 2017](#). The [Government's proposals](#) were:

There is clearly a need for a fairer and better framework for the setting of the discount rate. The Government intends to make the following changes to the law:

- The rate is to be set by reference to expected rates of return on a low risk diversified portfolio of investments rather than very low risk investments as at present; and in assessing those rates the actual investment practices of claimants and the investments available to them should be considered. This will make the rate more realistic.
- The principles for the setting of the discount rate should be set out in statute.
- The rate is initially to be reviewed promptly after the legislation comes into force and, thereafter, at least every three years, with that period being re-set when the rate is changed. Reviews will be completed within 180 days of starting. This will avoid overlong delays between reviews, which will make changes in the rate more predictable and manageable.
- The rate is to be set by the Lord Chancellor with advice from an independent expert panel (other than on the initial review which would be by the Lord Chancellor with advice from the Government Actuary). HM Treasury will, as at present, also be a statutory consultee for all reviews. The panel will be chaired by the Government Actuary and include four other members having experience as an actuary, an investment manager and an economist and, finally, experience in consumer investment affairs.
- It will continue to be possible to set different rates for different types of cases, including by reference to the length of the award.

The key phrase was that set out in paragraph a) – “The rate is to be set by reference to expected rates of return on **a low risk** diversified portfolio of investments rather than **very low risk** investments”. This small change of emphasis, it is calculated returns the rate to 0% - 1%, a range many insurers expected. In a n article in Post Magazine³⁹, accountants Deloitte estimate that the move from minus 0.75% to plus 1% “could be (worth) in the range of £300m to £600m across the market”. Estimates of the impact of the rate change on premiums were also reduced. Average reinsurance rates that might have risen by between 30% and 50% were now expected to rise by only 5% - 15%.⁴⁰

3.5 New legislation

Draft clauses to effect the changes [were published](#) at the same time. There is no indication yet as to when any legislative measure will be published.

The Justice Select Committee produced its [Report](#) which considered the draft clauses on 29 November 2017. It summarised the proposed changes to the system of setting the rate:⁴¹

³⁹ Post Magazine, October 2017, p9

⁴⁰ Post Magazine, October 2017, p10

⁴¹ Justice Select Committee; [Pre-legislative scrutiny: draft personal injury discount rate clause](#); HC 374 2017-9, November 2017

Status quo	New Proposals
Lord Chancellor sets rate after consulting Government Actuary and Treasury	Lord Chancellor sets rate after consulting expert panel and Treasury
No fixed review of discount rate	Discount rate set at least every 3 years
Assumptions about investment of lump sums derive from case law (Wells v Wells)	Assumptions derive from legislation
Rate should be set on the assumption that lump sums are placed in very low risk investments, by reference to yields on Index Linked Government Securities	Rate should be set on the assumption that the recipient of the relevant damages invests the relevant damages in a diversified portfolio of investments; using an approach that involves (1) more risk than a very low level of risk, but (2) less risk than would ordinarily be accepted by a prudent and properly advised individual investor who has different financial aims

Source: Justice Committee

The following summarises some of its main conclusions.

Compensation

There was general approval from the Committee and witnesses that the Government is committed to the principle of 100% compensation for loss. However, achieving that is a practical impossibility on a sustained basis, hence the 100% aim might be more usefully defined.

There was a range of views about whether the current negative rate 0.75% left claimants over compensated or not. It was noted that the draft legislation bases the determination of the rate on claimant behaviour rather than on a defined set of 'risk free' investment instruments. Typically claimants invest in low risk instruments which return much more than zero risk ones. In a typical case, therefore the claimant will get more than the award value. Whether this should be described as 'over compensation' or simply a reward for taking greater risk, was disputed.

Total compensation also depends on longevity too which claimants cannot predict with accuracy. In cases of long term care the rate at which care costs increase and the length of time they increase over will have a significant impact on the balance of over or under compensation.

All parties agreed that any investment adviser who only invested according to the legal basis (i.e. only in index linked gilts) would be "crackers". However, whatever the discount rate is set at (for example past returns) determines the forward investment strategy of claimants, because if they don't achieve a rate of return equal to the discount rate they will struggle to live. The discount rate at the point of the determination of quantum, fixes the sum available to invest. Over the remaining period claimants need to at least match that rate or be 'under' compensated.

Balancing costs and benefits

Much of the debate over the setting of an appropriate level of rate is set in the context of a zero sum binary game: high rates good (for insurance industry), bad (for complainants) – and vice versa. Into this scenario the committee noted that Government was attempting to introduce a third factor, namely:

the social benefits which would arise from lower insurance premiums and reduced clinical negligence costs resulting from the higher discount rate. The Command Paper argues that "The unrealistic assumptions currently being used" to set the discount rate:

are having a significant effect on taxpayers through the additional cost of personal injury settlements paid by the National Health Service and other public sector bodies;

and businesses and individual consumers through insurance premiums that are higher because awards of damages may be providing more than 100% compensation.⁴²

The Report highlights the interrelationship of several of the variables in the calculation of an ideal discount rate. A lower rate, because it causes premiums to rise, raises insurance premium tax receipts, but under compensation could impose public health costs if claimants could not finance their own treatment throughout their lives. It also notes the social justice aspects of the decision. Under-compensation would affect poorer people more than wealthier ones – they have less other resources to fall back on - with a possible policy imperative that:

88. We recommend that instead of targeting 100% compensation, neither “under” or “over” compensation, the Government should consider adopting as a target the median level of compensation to tend towards over-compensation; or should at least ensure that there are adequate safeguards to prevent significant under-compensation of the most vulnerable claimants.⁴³

The Committee questioned whether there was sufficient evidence to think that premiums would fall as fast as they had risen, following the rate cut, if the rate was raised. It also focussed on the costs to the NHS in the payment of clinical negligence claims:

97. In March 2017, the OBR stated that the reduction in the discount rate to 0.75% would affect their fiscal forecast: “the Government has added around £1.2 billion a year to the ... reserve to meet the expected costs to the public sector, in particular to the NHS Litigation Authority”.⁴⁴

⁴² Justice Select Committee; [Pre-legislative scrutiny: draft personal injury discount rate clause](#); Chapter 4

⁴³ Justice Select Committee; [Pre-legislative scrutiny: draft personal injury discount rate clause](#); Chapter 4

⁴⁴ Justice Select Committee; [Pre-legislative scrutiny: draft personal injury discount rate clause](#); Chapter 4

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