Society of Actuaries in Ireland

Response to Department of Justice and Equality consultation on Legislation on Periodic Payment Orders

September 2014

A. Introduction

A1 The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland. Many of our members work in the non-life and life (re)insurance industry. Some carry responsibilities relating to the determination of technical provisions for insurance liabilities. Others are engaged in designing, pricing and underwriting products and in managing the risks inherent in insurance portfolios. Many also carry broader management responsibilities, including strategy planning and implementation. We can therefore draw on a wide range of expertise when we contribute to debate on insurance matters.

A2 One of our primary goals is to make informed and impartial contribution to debate on matters of public interest where an actuarial dimension can add value. We therefore welcome the invitation of the Department of Justice and Equality to contribute to a consultation on Legislation on Periodic Payment Orders. We hope that our input will be useful to the Department's ongoing work on considering whether there are obstacles that stand in the way of extending PPOs to private defendants, and if so, how these obstacles might be addressed.

A3 We focus in this paper on PPOs against private defendants where third party non-life insurance cover is in place in respect of some or all of the event that gave rise to the PPO. Where no insurance cover is in place, it may be appropriate in any event for certain claims to be settled by means of PPO, in the interest of consistency of treatment across claimants; however, the question of the security of continuity of benefit payments may require even greater attention in this case.

B. Payment of benefits under PPOs

B1 It is useful to consider first what arrangements might be made for the payment of PPO benefits, as this may inform decisions on other questions, such as what the scope of PPOs should be.

B2 In its October 2010 Report[1], the Working Group on Medical Negligence and Periodic Payments identified security of payments as a key issue. The Group proposed that courts should be empowered to make PPOs only where satisfied that the continuity of payment under the order is reasonably secure. We agree that this is a critical consideration in deciding whether, and if so how, PPOs should be extended to private defendants.

B3 Options that exist for payment of PPO benefits, in cases where non-life insurance cover is in place in respect of some or all of the event that gave rise to the PPO, include:

(a) The liability rests fully with the non-life insurer;

(b) The insurer has the option, or is required, to transfer the liability to an insurance pool;

(c) The insurer has the option, or is required, to transfer the liability to a State agency. We agree with the Medical Negligence and Periodic Payments Working Group that the NTMA would be a logical choice, given its multiple treasury functions on behalf of the State.

Each of these has different implications in terms of security of continuity of payment, as discussed below. Ensuring complete security under options (a) or (b) would, we suggest, require State involvement, which may be to fulfil any shortfall in the event of the failure of an insurer or the insurance pool, or to dictate how such a shortfall is to be met (e.g. through some form of levy on insurers).

Option (a) – liability rests with non-life insurer

B4 If PPOs are set up in such a way that the liability rests fully with the non-life insurer: Non-life insurers have expertise in establishing the quantum of benefits, evaluating risks, determining reserving and capital requirements and implementing appropriate asset/liability matching strategies <u>for insurance portfolios where claims are settled by means of lump sums</u>. However, the nature of a PPO is very different. Therefore, a number of issues may arise, as set out below. Note that we assume that benefits payable under PPOs will be subject to review only in very limited circumstances, though stepped increases at specified dates may be built into the PPO (see Section C, paragraph 3.2 and response to question 4).

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1 http://www.courts.ie/Courts.ie/library3.nsf/(WebFiles)/5CEEA19C4A5959BC802577DC0055C9F4/$FILE/Medical%20Negligence%201.pdf

(a) PPOs are likely to increase the risks and uncertainties inherent in insurance portfolios:

(i) PPO liabilities are typically significantly longer than any other insurance or pensions liabilities, and may extend for durations of 80 years or more. Moreover, they are typically payable to persons who have suffered catastrophic injuries and are unlikely to experience standard mortality or morbidity rates. There is little, if any, reliable morbidity or mortality experience data available internationally to value liabilities of this type, and (as far as we are aware) there is no Irish-specific data.

- This will create uncertainty in the pricing of products and in the valuation of liabilities. This, in turn, may lead to higher prices and to a need for insurers to hold increased amounts of capital.
- It may also lead to inconsistency between insurers in pricing and reserving assumptions. Inconsistency in assumptions may mean that the least prudent assumptions are "rewarded" through a lower adverse impact on profit and a lower impact on pricing. This may, however, have a negative impact on the security of payment of benefits in the medium- to long-term.

(ii) Achieving adequate matching of assets and liabilities is likely to be very difficult, if not impossible.

- As indicated, some PPOs will be payable for many years - but there are no assets available of sufficiently long duration to match these liabilities. This means that insurers will bear reinvestment risks above and beyond current investment risks and in addition to the risks mentioned above.
- One possibility is that the government could issue long-dated securities linked to an appropriate index. This would certainly be helpful. However, even then, the range of securities would probably be limited, and it is unlikely that individual insurers would be able to achieve adequate matching, given the relatively small number of PPOs that any given insurer will carry and the unique circumstances of each PPO.

(b) It should also be noted that Solvency II[2] brings onerous capital requirements for PPO-like liabilities. This will put further financial stress on insurers. Another consideration is that the capital requirements for PPO claims are higher than for lump sum claims, since the investment risk is now with the insurer and will stay with it for longer.

(c) Most insurers will look to reinsurers to take on the cost of potential large claims that would otherwise destabilise the insurer's results and possibly jeopardise solvency.

(i) However, reinsurers will also face the issues identified above. Therefore, it cannot be assumed that reinsurers will be willing to provide cover to the extent required.

[2] Solvency II is a new regulatory regime for EU (re)insurers that will come into effect from 1st January 2016. It will introduce updated and harmonised approaches to determining the technical reserves and capital that (re)insurers need to hold in respect of risks underwritten.

- As an example of experience elsewhere: in the UK, the motor reinsurance market is increasingly moving towards capitalised products which will move the risk back to insurers after a specified period; and we understand that the introduction of PPOs has led to reinsurers withdrawing from some segments of the market altogether.

(ii) If there is only a small reinsurance market for PPOs, and/or an uncompetitive market, this will impact on direct writers' capacity to provide insurance cover.

(iii) Contraction of reinsurance capacity, combined with the risks and uncertainties involved in managing claims settled by PPO, could have a substantial effect on smaller insurers, in particular. If a small insurer becomes liable for a PPO settlement without reinsurance cover, the reserving and capital implications arising from the uncertainties involved may be disproportionately large relative to its capital and reserves. Contraction of reinsurance capacity may therefore lead to some insurers having to curtail the amounts and/or types of insurance covers they provide. It may also discourage new players from entering the market. Both of these effects could restrict competition.

(d) Further considerations are the administration costs of managing PPO claims over a long period, the uncertainty over possible inflation effects and the need to develop new claims processing systems to deal with recurring rather than lump sum payments.

(e) Notwithstanding that insurers are subject to extensive reserving, risk management and solvency capital requirements, the new uncertainties and risks that PPOs create for insurers have the potential to reduce the security of payment of benefits below a level that might, at a societal level, be considered acceptable for beneficiaries who have suffered catastrophic injuries and require long-term medical care. It is difficult to quantify the risks identified above, or predict over what timescale they might become material issues. Nonetheless, we suggest that such an analysis be attempted as part of a regulatory impact analysis, if a policy decision to extend PPOs to private defendants and to require insurers to hold the resulting liabilities on their balance sheets is being considered.

Option (b) – an insurance pool is established

B5 Given the issues identified at B4, we suggest that the establishment of an insurance pool to deal with PPO settlements merits careful consideration.

(a) When the PPO is made, the insurer would (subject to (b)) discharge its liability in respect thereof by making a lump sum payment to the insurance pool.

(b) If the PPO provides that it may be varied upwards at a future date (e.g. if specific conditions are met), this may result in a further lump sum payment by the insurer to the pool at that date.

(c) If the PPO provides for stepped increases in payments – e.g. where increases in future care needs can be anticipated at outset – these could be reflected in the lump sum paid to the pool at outset, or the insurer could be required to make a further lump sum payment to the pool when the higher payments commence.

B6 Thus, a pool would allow insurers to convert their PPO liabilities into a lump sum and hence reduce future risks and uncertainties, with positive impacts on capital management and insurance capacity. It would, in effect, facilitate pooling of risks between insurers.

(a) Issues such as the difficulties in predicting future morbidity and mortality experience, and matching assets and liabilities, would remain. However, the increased scale, compared with the PPO liabilities of any individual insurer, should enable the pool to better mitigate the risks and should therefore increase the security of payment of benefits.

(b) The greater scale should also facilitate efficiencies, and therefore cost savings, in the administration of claims.

B7 We suggest that, if this approach is adopted, it should be mandatory for insurers to transfer all personal injuries claims settled by means of PPOs to the pool. This would ensure consistency across claimants and would prevent insurers from choosing to transfer only their highest risk / most uncertain PPOs to the pool while retaining others on their balance sheet.

B8 Establishing a pool would require careful planning. Questions to be considered include:

(a) Who should operate the pool?

(b) How should the assumptions underpinning the calculation of lump sum payments to the pool be decided?

(c) If these assumptions prove to be too optimistic and further funding is required at a future date, how should this be dealt with? E.g. the pool could have authority to require further payments from insurers.

(d) If the assumptions prove to be too pessimistic and surpluses arise, how should these be dealt with?

(e) What steps should be taken to maximise security of benefits, particularly if the legal structure is such that the pool does not have to meet the solvency capital requirements that would apply to insurers? Given the long-term medical needs of the beneficiaries, should the liabilities of the pool ultimately be guaranteed by the State?

(f) How would reinsurance companies treat payments to a pool? There may be circumstances in which reinsurers would not treat these payments as claim payments. This could pose significant problems for insurers, if, having made payments to the pool, they could not be recovered from the reinsurer (or there was a long delay in recovery).

We would be happy to work with the Department to explore these and other questions, if this would be helpful.

Option (c) – liability is transferred to the NTMA

B9 Another possibility is that the NTMA would take on responsibility for administering claims settled by PPO. Allowing, or indeed requiring (see B8), insurers to discharge PPO liabilities by making a lump sum transfer to the NTMA would be optimal for PPO beneficiaries in terms of ensuring the security of benefit payments.

B10 As with option (b), the question of how the assumptions underpinning the calculation of lump sum payments to the NTMA should be decided would need careful consideration.

B11 If the NTMA assumed the risk of funding shortfalls as a *quid pro quo* for the fact that surpluses may arise and be retained, the arrangement would also remove uncertainty for insurers (albeit at a cost – the fact that the uncertainty would now be borne by the NTMA would be reflected in the transfer terms).

B12 An argument can perhaps be made that it is not appropriate for insurance risks to be transferred to a State-backed agency and for the State, and hence the public purse, to bear the risk that the transfer terms turn out to be inadequate. On the other hand, this may be deemed acceptable in the limited circumstance of PPOs, in the interest of providing financial security to persons who have extreme medical care needs. Moreover, the risk currently exists that a lump sum settlement will prove to be insufficient to finance long-term care needs and that costs will fall back to the State through the social welfare system. We have not considered this question in depth.

C. Consultation questions and responses

1. Please indicate your views as to whether the legislation should provide for:

(a) periodic payment orders to be limited to catastrophic injury cases only;

(b) periodic payment orders to be available in relation to personal injuries claims above a certain cost and in which the person requires long-term care.

1.1 For reasons of equality/fairness and the lack of clarity of a definition of catastrophic injury, we would propose (b) (while acknowledging that "long-term care" would then need to be defined). We would add that the key determinant should be the long term care cost. However, (b) implies greater volumes of PPOs and hence the issue of security of payment (highlighted in the October 2010 Report of the Working Group on Medical Negligence and Periodic Payments) is more important.

2. ***Please indicate your views on whether a settlement involving a periodic payment order should be:***

(a) mandatory in all cases;

(b) mandatory when requested by the parties; or

(c) left to the discretion of the court.

2.1 These cases are relatively few in number, but each case is unique, so we would favour (c).

2.2 In some cases, there will be a need for a lump sum payment in addition to recurring payments, to cover immediate special needs (e.g. housing changes, vehicle and assistive equipment purchases, etc).

2.3 Consideration will need to be given to details such as how to structure benefit payments where only part of the liability is covered by insurance (e.g. cover under employer's liability, household and travel insurance is typically subject to a fixed limit), and how to deal with claims where either the claimant or the defendant is not resident in the State.

3. ***Please outline your views as to how the security of payment for a periodic payment order should be guaranteed.***

3.1 As indicated at B10, allowing, or indeed requiring, insurers to discharge PPO liabilities by making a lump sum transfer to a State-backed agency would be optimal for PPO beneficiaries in terms of ensuring the security of benefit payments.

3.2 If the decision of Government is that PPO liabilities should instead remain with individual insurers or with an insurance pool without some form of State protection, then we do not believe that it would be possible to absolutely guarantee security of payments. In this instance, decisions need to be made as to the allowable scope of PPOs – balancing claimants' needs to have their long term care needs addressed with insurers' needs to be able to manage and mitigate the risks that they underwrite. From a societal perspective, both are legitimate and, indeed, important needs.

- PPOs that can be revisited in the event of any deterioration in the beneficiary's medical condition, or in the event of increases in medical care costs for any other reason, would be optimal from the beneficiary's point of view.
- However, for the reasons set out at B4, we think that the implications for (re)insurers in terms of reserving and capital requirements could be quite significant. Recent experience in the UK has shown a contraction in reinsurance capacity. If this experience was repeated in Ireland, it would have consequences for the direct market.
- A more balanced approach is therefore needed, such as that suggested at the response to question 4.

4. ***Please indicate your views with regard to:***

(a) the circumstances in which periodic payment orders should be varied;

(b) the possibility of providing for stepped payments to address specified changes in a claimant's care needs.

The circumstances in which periodic payment orders should be varied

4.1 As indicated at the response to question 3, a system under which PPOs could be varied at any time to allow for any unforeseen deterioration in the recipient's condition, or in the costs of medical treatment or other relevant expenses, would be optimal from the recipient's point of view. However, there would be no certainty for the defendant if PPOs could be varied at any time. Allowing this degree of reviewability could make PPOs prohibitively risky for providers and this would be reflected in insurance premiums and in insurers' capacity to provide cover.

4.2 As a more practicable approach, we suggest that, where there is uncertainty at the time of the initial award as to the full extent of the condition of the injured, and where there is a reasonable expectation at that time that a clearer determination can be made at a future date, then the possibility for variation on specific conditions (e.g. the delayed onset of epilepsy as a consequence of the event which gave rise to the PPO) could be allowed for at the outset. For example: initial award of €X p.a. which may be increased to €Y p.a. based on a specific test/diagnosis and Court approval (it may also be appropriate to include constraints as to the period during which such test/diagnosis must be performed). We would expect the proportion of such cases to be small.

4.3 Note that if legislation is introduced at a future date that extends on a retrospective basis the scope to vary PPOs, this could have a very destabilising effect on the insurance market and, if applicable, on any insurance pool established for the purposes of PPOs.

<u>The possibility of providing for stepped payments to address specified changes in a claimant's care needs</u>

4.4 This makes sense as it is just a further refinement of the concept of meeting the care needs as they fall due, e.g. a pre-determined step-up in care needs at certain life stages. We would expect such cases to be quite common. It is quite common currently for this to be allowed for in lump sum settlement calculations.

5. *Please indicate your preferences as to whether the index used to underpin periodic payment orders should be:*

(a) a currently published general index such as the Consumer Price Index (CPI) or the Harmonised index of Consumer Prices (HICP);

(b) a subset of the CPI/HICP which specifically covers health costs, that is, COICOP Division 6 in full, or elements of it;

(c) an index specifically developed for this purpose;

(d) If (c); (i) should this index track medical and social care costs, such as the ASHE 6115 in the UK? Or (ii) track other costs? (please specify); Or (ii) track other costs? (please specify);

(e) Any other type of index; please specify.

5.1 This is one of the most difficult aspects of PPOs.

(i) An index that is too granular will exhibit significant volatility, which is not in the interests of any of claimants or insurers. For example, in Ireland, an index based specifically on carer earnings may be quite unstable, whereas a wider national average earnings index may be less so. UK experience with ASHE 6115 suggests that such a small group does not give stability to the claimants. Since the Irish population is smaller, any index developed in Ireland is likely to be more volatile.

(ii) Pure price indices will not match cost escalation in the medium/long-run. A wage-related component is essential.

(iii) There would be difficulty for insurers in finding matching assets. For example, there are no bonds issued to match Irish price inflation. Matching wage inflation is even more difficult. (Note that this would not be an issue if PPO liabilities were discharged by transfer to a State agency).

The above suggests that a wide national average wage index may be most appropriate, with a medical element at a suitable weighting.

6. Please outline any other views that you may have regarding the proposed legislation.

Managing expectations

6.1 From a claimant's perspective, the risks from a lump sum settlement for future care are:

(i) Care needs change unexpectedly;

(ii) Investment proceeds are not sufficient;

(iii) The claimant lives longer than expected.

6.2 We believe that, compared to a lump sum settlement, a PPO reduces the risks for an individual claimant. However, PPOs also have risks, and care is needed to ensure that claimants do not have unrealistic expectations. Some examples of issues that can arise:

(i) The claimant's medical condition may deteriorate or costs of care may increase at a higher rate than the rate of increase in the escalation index. This risk will remain with the claimant, unless it is recognised at time of settlement in the form of a variation order or a stepped payment.

(ii) A PPO settlement is designed to remove the risks that the claimant lives longer than expected and that the investment proceeds from a lump sum award are below the level assumed in the settlement. Although variable PPO awards can be made, we suggest (see 4.2 above) that the conditions for these to trigger need to be considered in advance. However, it is unrealistic to expect to be able to forecast all possible changes over the claimant's future lifetime (potentially 80 years or more). Thus, the claimant remains exposed to risk that the PPO will not be adequate.

There is also a material issue where there is contributory negligence on the part of the injured person, e.g. in the case of a motor accident. A PPO paying 50% (say) of the annual cost of medical care is of limited use in practice to the injured party. In these circumstances, the settlement may include a lump sum to tide the party over for a number of years, but there is a long-term problem of insufficiency of funds relative to care needs. Of course, PPOs are not intended to solve this problem; nonetheless, it is worth bearing in mind as another example of a situation where it will be important to manage expectations.

Other considerations for Government

6.3 Government may legitimately be concerned that any insufficiency in the amount of a PPO will fall to be met by the general exchequer through social welfare benefits. This could arise if care needs change and suitable top-up arrangements are not in place, or where there is contributory negligence (as discussed above). However, the risk of insufficiency of funds exists also with the current lump sum system of settlement of claims. An advantage of PPOs over lump sums is that, if lifespan proves to be shorter than expected, the PPO ceases, whereas the lump sum has already been paid in full and is not recoverable.

6.4 If PPOs are introduced for private defendants and if insurers are required to hold them on their balance sheets or transfer the liability to an insurance pool, the NTMA should consider issuing securities that would enable insurers / an insurance pool to achieve some degree of matching of assets and PPO liabilities. These securities would have to be very long-dated and match to the escalation index selected.

Please direct any questions on this paper to Yvonne Lynch, Director of Professional Affairs, Society of Actuaries in Ireland, at the contact details overleaf or at: Yvonne.Lynch@actuaries.ie.

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