

# Periodical Payments and the Courts Act

**Working Party:** Fabrice Brossart, Catherine Cernesson, Doug Brown, Catherine Gwinnett, Sheree Howard, Simon Marks, Joe Monk, Jamie Reid, Anthony Williams (Chair), Gary Yeates

**Keywords:** "Courts Act", "Periodical payments", "Personal injury compensation", "Structured settlements"

## 1 Summary

From 1 April 2005 the Courts Act 2003<sup>1</sup> introduced the greater use of periodical payments in personal injury cases. It allowed courts to impose periodicals even if neither the claimant nor the defendant requested them.

Periodical payments are intended to compensate claimants for future financial loss (cost of care and possibly loss of earnings) in personal injury cases. Claimants receiving periodical payments are likely to receive a lump sum for some part of the award, and lump sums will still remain the appropriate type of payment for some claimants. The aim of this new legislation is to improve compensation for personal injury claimants by determining settlements from "the bottom up" (as opposed to "top down"), by reviewing the needs of claimants and then designing the award accordingly<sup>2</sup>.

The rationale for this is that the investment and mortality risk should be taken by the insurer rather than the claimant. It is the insurer who is more able to take these risks, giving the claimant greater certainty.

In March 2005 the Damages Working Party of the Institute and Faculty of Actuaries hosted a seminar "From Lump Sums to Periodic Payments and Beyond"<sup>3</sup>. Staple Inn was filled not just with actuaries but also with lawyers and claims specialists indicating the wide interest in this topic.

This highlighted the significant impact periodical payments will have on the insurance industry, not only in the area of reserving, but also in areas including claims management, pricing, reinsurance, investment strategy and capital management.

It is still very early for this new basis of compensation and few have been awarded under the new basis as at August 2005. With this in mind, the aim of this paper is to provide a guide on periodical payments to actuaries, underwriters, claim handlers, solicitors and other professionals involved in the insurance industry. This paper addresses the issues facing insurers and reinsurers with respect to the introduction of periodical payments, with the objectives being to:

- Provide a brief background to periodical payments and the new legislation
- Comment on the possible operational impacts on UK insurers and reinsurers
- Provide a view on the potential financial impacts on insurers and reinsurers
- Provide material for further reading on the detail of the legislation and its interpretation

---

<sup>1</sup> Specifically sections 100 and 101 which are included in Appendix C

<sup>2</sup> from Damages Working Party discussions with the Department of Constitutional Affairs ("DCA")

<sup>3</sup> [http://www.actuaries.org.uk/Display\\_Page.cgi?url=/damages/seminar20050307.html](http://www.actuaries.org.uk/Display_Page.cgi?url=/damages/seminar20050307.html)

The financial implication of periodical payments for insurers and reinsurers is a complex issue, particularly with indexed deductibles. This paper demonstrates the sensitivity of the value of the retained loss for both the insurer and reinsurer on claims by adjusting the age of claimant, the level of the excess of loss retention, the settlement delay and the real discount rate. The total value and reinsurance recoveries for each periodical payment award must be valued and actuaries are in a good position to do this.

In order to understand the impact on insurers the Working Party has carried out an informal survey of selected insurers which aimed to collate information on periodical payments awarded to date, whether any systems changes have been required, how insurers are intending to fund the claims, reinsurance issues encountered and whether there have been or are expected to be any cost and reserving impacts.

The Working Party would like to thank and acknowledge the contributions from numerous sources namely the International Underwriting Association (IUA), insurers participating in the survey, Anthony Carus, Paul Mahon, various claims specialists and the Institute and Faculty of Actuaries Damages Working Party.

Any errors or omissions in this paper are our own and we would welcome any comments or feedback that anyone may have.

*The views expressed in this paper are those of the Working Party and do not necessarily represent the views of every member or of any organisation with which any member of the group is, or has been, associated.*

## **Contents**

### **1 Summary**

### **2 Background**

- 2.1 Principles of UK Compensation
- 2.2 Why introduce periodical payments
- 2.3 Courts Act 2003 – Periodical Payments and the Law

### **3 Understanding the impact of periodical payments on insurers**

- 3.1 Introduction
- 3.2 Which claims will be affected?
- 3.3 New Risks to Insurers
- 3.4 Options for insurers
- 3.5 Investment Options
- 3.6 Reserving for Periodical Payments
- 3.7 Discounting
- 3.8 Capital
- 3.9 Pricing

### **4 Impact on claims management**

- 4.1 Introduction
- 4.2 Claims function structure
- 4.3 Claims function systems
- 4.4 Case estimates
- 4.5 Variation of periodical payments
- 4.6 Involvement of reinsurers
- 4.7 Settlement strategy
- 4.8 Part 36 offers

### **5 Reinsurer specific issues**

- 5.1 Reinsurance
- 5.2 Attachment & indexation of reinsurance policies
- 5.3 Claims settlements & capitalisation
- 5.4 Variation order
- 5.5 Effect on pricing

### **6 Financial Impact - Modelling the impact of periodical payments (verses lump sum awards)**

- 6.1 Introduction
- 6.2 Individual claims impact
- 6.3 Assessment of the increase in claims costs

### **7 Survey results**

- 7.1 Introduction
- 7.2 Basis of the survey
- 7.3 Survey results
- 7.4 Summary

### **8 International perspective**

- 8.1 Summary by Country
- 8.2 Case Estimation
- 8.3 Reserving methodologies
- 8.4 Discounting
- 8.5 Claims Management
- 8.6 Reinsurance

## **9 Looking forward**

- 9.1 Future Developments
- 9.2 Positive Opportunities

### **Appendices**

- A. Our survey**
- B. Sections 100 and 101 of the Courts Act 2003**
- C. Explanatory notes to the Courts Act 2003 – Damages Section**
- D. The Civil Procedure (Amendment No. 3) Rules 2004 including Periodical Payments under the Damages Act 1996**
- E. The Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 -  
Schedule 1 - Form and Content of Accounts of Insurance Companies and Groups -  
Provisions for Claims Outstanding General Business**
- F. DCA – Guidance on Periodical Payments**
- G. Expected increase in reserves compared to Ogden**

## 2 Background

### 2.1 Principles of UK Compensation

Awards for damages in personal injury cases follow the Roman principle of *restitutio in integrum*, meaning that the claimant should be restored as far as possible to the position that they were in prior to the injury. This has generally meant monetary payments in the form of lump sums and initial medical treatment, but could include rehabilitation or other means of restoring the claimant to their original position.

Or, in the words of Lord Blackburn (*Livingstone v Rawyards Coal Company* (1880) - 5 App Cas 25 at 39) :

- Victims who have future loss as a result of a wrongful injury are entitled to full compensation – “that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation”

The Damages Act 1996 introduced the Ogden Tables as admissible evidence to support the calculation of lump sum awards. This also provided the Lord Chancellor the power to specify the discount rate to be applied to determine the lump sum amount. Whilst Structured Settlements have been used since 1989, the 1996 Damages Act gave the court the power to order a structured settlement only where both parties consented. There have been relatively few of these to date.

Further information on Structured Settlements and the Principles of UK Compensation can be found in the Structured Settlements Working Party Paper written in 2000<sup>4</sup>.

The introduction of the Courts Act 2003 requires the court to assess which of lump sum compensation on the Ogden basis, periodical payments, or a mixture of both is the most appropriate form of compensation for each case. One important difference is that the court can order a settlement using periodical payments without the consent of either party.

### 2.2 Why introduce periodical payments

The aim of introducing periodical payments is to improve compensation for personal injury cases as periodical payments are a more appropriate match for certain heads of damage. Additionally, they avoid the situation where a claimant works his way through a lump sum award and then falls back on the State for support, or where a claimant is so concerned about using up the lump sum that they do not spend the required amount of money on their welfare.

Structured settlements had been intended to bring many of the benefits that periodical payments are now promising, although they were never used as widely as first thought. This is potentially due to the “top down” approach (see below) employed to calculate the amount, the need to purchase an annuity at rates which may not have been favourable and consent being required by both parties. However, structures are still being used for out of court settlements and being approved by the courts.

The “top-down” approach estimates a lump sum by multiplying the estimated annual payments to the claimant (the multiplicands) by the appropriate multipliers (from the Ogden Tables – which allow for mortality and the real discount rate). This lump sum is then used to purchase an annuity.

Periodical payments aim to remove these restrictions by calculating an award using a “bottom up” approach (see below) and requiring the insurer to provide the regular payments rather than providing a lump sum from which to purchase an annuity. The decision as to the form of

---

<sup>4</sup> The paper can be found at [http://www.actuaries.org.uk/files/pdf/library/proceedings/gen\\_ins/2000gic/stuct\\_sets\\_wp.pdf](http://www.actuaries.org.uk/files/pdf/library/proceedings/gen_ins/2000gic/stuct_sets_wp.pdf)

the award now rests with the court to the extent that a court can order a periodical payment even if both the claimant and the defendant state that they prefer settlement in the form of a lump sum. Indeed, this was the case in the first periodical payment settlement (Godbald vs Mahmood) where the judge ordered a periodical payment against the defendant, as it was considered to be in the claimant's best interest, despite neither the claimant nor the defendant indicating that this was their preference.

The "bottom-up" approach estimates the annual amount (which usually inflates at the Retail Prices Index ("RPI")) required by the claimant, and a periodical payment order is made to provide those payments for as long as required.

From the claimants' perspective, while lump sums may offer benefits including a clean break from the insurer and maximum flexibility, they do leave the claimant with significant risks including:

- Investment risk
- Mortality risk – specifically if they live longer than actuarially "expected"
- Inflation risk

Settlement by periodical payments results in claimants transferring at least some of these risks to the insurer, although arguably the claimant could be left with a significant inflation risk. For example, if medical care inflation is greater than the increase in the RPI, the periodical payment may become insufficient to pay the medical care costs.

Periodical payments also have potential non tangible benefits to the claimant in that they avoid the need for often stressful discussions in court about their life expectancy, and can supply a sense of security or certainty.

It is a stated intention of the government that periodical payments in personal injury cases are to become the norm, rather than the exception. Baroness Scotland used the phrase "These proposals aim to promote the widespread use of periodical payments ..." {Lords Hansard 27 March 2003 Col 930} and the paragraph 11 of the DCA Guidance note states "Ministers indicated that ... they hoped that the use of periodical payments in appropriate personal injury cases would become the norm ...".

## **2.3 Courts Act 2003 – Periodical Payments and the Law**

The Courts Act 2003 contains 112 sections primarily relating to the administration of the courts system. The act is retrospective, and applies to all judgements on or after 1 April 2005. Under the heading "Part 8 Miscellaneous" subheading "Damages" there are two sections that fundamentally change the rules for personal injury compensation:

- Section 100 – Periodical payments
- Section 101 – Periodical payments: security

These sections can be found in Appendix B.

In the explanatory notes to the Courts Act 2003, included as Appendix C, the aim of the periodical payments legislation is "to promote the widespread use of periodical payments as the means of paying compensation for future financial loss in personal injury cases".

The DCA, to produce the final form of the Courts Act 2003, consulted widely including meeting with the Damages Working Party.

Below we have included a brief introduction to the legislation, which explains and expands on the rules. Further guidance has been issued by the DCA, Appendix F.

## Basis of awards

The Courts Act 2003 (sections 100 and 101) provides for amendments to the Damages Act 1996 and give the court the following powers in personal injury cases:

The court is **required to consider** making an order for awards in respect of future pecuniary loss to be paid in full, or in part, by periodical payment instead of by lump sum;

The court can award payment by periodical payment in respect of future pecuniary loss **without the consent** of the parties;

The court may also order periodical payments in respect of any other head of loss **with the consent** of the parties.

In deciding whether periodical payment may be an appropriate form of payment the court will consider<sup>5</sup>:

- The form of award that best meets the claimant's needs and have regard to all the circumstances of the case
- The scale of the annual payments taking into account any deduction for contributory negligence
- The form of award preferred by the claimant (the reasons for it and the nature of any financial advice received)
- The form of award preferred by the defendant including the reasons for the defendant's preference

Thus, for the future pecuniary losses the court has the power to decide whether award should be made fully or in part in the form of a periodical payment. There seems to be little in the way of guidance as to how the court should decide what is in the best interests of claimants. The claimants and defendants will potentially be expected to produce advice from an Independent Financial Advisor upon which the court can make a decision. However the court can ignore the wishes of both the claimant and defendant and award what it determines to best meet the claimant's needs.

The court can also award periodical payments that continue after the claimant's death, to his or her dependants. The order needs to specify the amount and duration of the award.

Contributory negligence may cause the courts difficulty in awarding periodical payments, especially for the medical care cost head of damage. For example having say 90% of the money required to receive treatment may result in practical difficulties for the claimant. Similar difficulties may arise with limits of indemnity.

Once the court has awarded the periodical payment order, the insurance company can decide how to fund the payments, so long as they are "reasonably secure".

## Security

The court **may not make an order unless satisfied that the continuity of payment under the order is reasonably secure**. Reasonably secure is classified as:

- Ministerial guarantee is in place
- FSCS protection
- Government health service body

---

<sup>5</sup> Civil Procedure Rules, Practice Direction 41b (Rule 41.7)

- Other circumstances where the court is satisfied that pay out at required level for the duration is reasonably secure

Since the Act came into effect, the Motor Insurers' Bureau (MIB) have successfully argued in the cases of Thacker vs. Steeples, and Daniels and Edge and MIB, that it should be considered reasonably secure and periodical payments orders were approved.

The FSCS provides protection for policyholders in the case of general insurer insolvencies. Section 4 of the Damages Act 1996 provides 100% protection under the FSCS for periodical payments for all but a few classes of insurance (including aircraft and ship liability). This does not mean that periodical payments can't be awarded against these classes rather that the methods of funding available are reduced.

From 1 January 2004, the central fund at Lloyds is protected by the FSCS; it is unclear whether this protection extends to Lloyd's syndicates.

Equitas is not covered by the FSCS and neither are captives or overseas insurers. In addition any organisation with an element of self-insurance may also not be considered 100% secure.

This has significant implications for the award of periodical payments against these insurers/organisations. It seems unlikely that a court would simply agree to a lump sum award in such a circumstance. Therefore, two options are possible: Firstly, the forced purchase of an annuity; Secondly the setting up of an escrow account which could fund the annual payments to an acceptable level of security. Neither of these possibilities has yet been tested in court and bodies like the Medical Protection Society (who are not an insurer and therefore not backed by the FSCS) have highlighted the potential additional cost that the Courts Act legislation will have on them.

The FSCS protection is only available to claimants, not dependants.

### **Taxation**

The **claimant** is exempt from income tax on the periodical payments made for **personal injury damages**; however dependants may be taxed on any payments that they receive.

Similarly an insurer holding annuities in its own name, which it intends to use to self fund a periodical payment, is liable for tax on any receipts from the annuity not paid to the claimant.

### **Variation in the level of payment – General variations**

If the periodical payment is to **increase or decrease** on a certain date this **must be specified at the time of the award** - examples of this may be that the<sup>6</sup>:

- Condition will lead to change in care needed
- Gratuitous care will no longer continue
- Educational circumstances will change
- Promotional increase in pay
- Cessation of employment

The courts have the power to award payments that vary automatically with the RPI. The court may consider an award that varies with respect of another inflation index. However this will only be allowed in "exceptional circumstances".

---

<sup>6</sup> Civil Procedure Rules, Practice Direction 41b (Rule 41.8)

Whilst the original legislation suggested that indexing can make allowance for the effects of inflation under various heads of damage, Parliament accepted RPI would normally be appropriate. Thus, the inflation link with the RPI is embedded into the legislation.

However, paragraph 10 of the DCA guidance<sup>7</sup> and the Lord Chancellor (when discussing the reasons for setting the discount rate) suggest that the court should consider the use of another index, but only in “exceptional circumstances”. What these exceptional circumstances may be is not defined, but considering that the claimant’s rights are central to this legislation there is potential for a challenge.

There has been several cases (*Warriner v. Warriner* [2002] 1WLR 1703, *Cooke & others v. United Bristol Health Care & others* [2004] 1WLR 251, *Sheppard v. Stibbe* [2003] EWCA Civ 1370) where the use of RPI has been challenged. All these cases were rejected. This issue is currently being challenged in *Harris v Gloucestershire Royal NHS Trust*.

### **Variation in the level of payment – Variation order**

A variation order can be made when the periodical payment is awarded to enable variation in the level of payments only where there is **significant medical deterioration or improvement in the claimant's condition which can be foreseen at the time of the original order** and where the court provides for the possibility of variation in that order.

Variation orders are prospective, and are only applied where proceedings are issued on or after 1 April 2005.

There has been much discussion around the ability to vary the award over time as circumstances change. Prior to the legislation coming into force there was significant concern that this could cause unacceptable uncertainty for insurers as many reasons could be used by the claimant to argue for an increase at some time in the future.

In the final version the use of variation orders was strictly limited. They are only allowed for significant changes in the claimant’s medical condition which can be foreseen at the time the court makes the award and that are specified in the variation order. There is, however, still flexibility around the timing at which a change under a variation order may be called for in the future.

Variation orders are different from provisional damage awards and it is possible that both could be used in the one award, although it is still unclear as to exactly how variation orders will work along side provisional damages. One possibility is that a provisional damage award could generally be used where a new condition may emerge from the original cause of injury, as opposed to a variation order where this relates to a change in an existing condition.

While the above represents the intended application of the rules, much interpretation will be required by the courts and we are still waiting for sufficient cases to see how practice will emerge.

## **3 Understanding the impact of periodical payments on insurers**

### **3.1 Introduction**

Periodical payments affect most aspects of a general insurer's business. In this section we firstly examine which classes and which types of claims are most likely to be affected. We then examine the new risks that general insurers will be facing and consider the options available to insurers to manage or mitigate some of these risks.

Following on we consider the impact on reserving, investments and matching, and the ability to discount periodical payment reserves. Here the difficulty of determining appropriate future mortality assumptions is examined, along with potential investment matching strategies to protect against the risk from the extremely long length of the payment period.

Finally we consider the impact on capital requirements and pricing.

### **3.2 Which claims will be affected?**

While the legislation relates to all personal injury claims made under the Fatal Accidents Act 1976 and the Law Reform (Miscellaneous Provisions) Act 1934, in practice only some claims will be affected. As discussed above in order for a periodical payment to be awarded to a claimant it must best meet the claimant's needs and the provider must be secure.

As there have only been relatively few periodical payments claims settled at the time of writing there is uncertainty around which types of claims the courts will consider appropriate for periodical payments. It seems likely that they will only be considered in cases where there is a future long-term pecuniary loss, including permanent disablement, and particularly where the claimant is not capable of making decisions themselves, for example patients and minors (where the Court has to approve the settlement). Other factors likely to affect which claims are impacted include the size of the claim (including any contributory negligence or limit of indemnity) and the level of uncertainty in life expectancy.

Which classes and which insurers are able to be awarded against due to the security requirements set out in the act is less certain.

The classes of business that are most affected are motor, liability (employers', public, aviation and marine) and medical malpractice. However it is uncertain how policy limits will interact with periodical payments.

### **3.3 New Risks to Insurers**

The introduction of periodical payments increases insurers' exposure to certain risks and/or costs, namely:

- Mortality (in particular long term future improvements in mortality over that implicit in the current Ogden tables)
- Net real investment returns, in particular the inability to match assets to the liabilities, including the resultant reinvestment risk
- Potential risk of inappropriate coverage afforded by reinsurance - reduced reinsurance recoveries and/or increased reinsurance credit risk (leading to increased reinsurance bad debt potential)
- Increased administration costs, (introducing systems to pay annually, checking the claimant is still alive, reinsurance recovery handling and so on)
- Mis-pricing risk

- Increased reserving risk

Insurers do have the opportunity to mitigate some these risks including through mitigation strategies in general and the funding options that they decide to take.

### **3.4 Options for insurers**

#### **Funding options**

Once a periodical payment has been awarded the insurer has two main funding options: self-funding or the purchase of an annuity. Insurers with a life arm could in theory pass on the liability. However, in practice, the regulatory requirements for regular inflation linked payments are currently far more onerous for a life insurer than a general insurer and it does not appear as if many life offices are taking on liabilities in this way, although it is possible that the regulations may change in the future.

#### **Purchase of an annuity**

The insurer could purchase an annuity, either directly on the claimant's behalf or alternatively as an investment.

In the latter case the insurer is really self-funding as the insurer would simply pass the appropriate payments to the claimant and retain the liability. This also has the advantage that the suitability of the annuity does not have to be approved by the court.

In the former case, the annuity is held by the claimant so the insurer is passing the liability to the life insurer. This has the advantage of removing the long term and unpredictable liability from insurers' balance sheets. The life office from whom the annuity is purchased takes on the liability of paying the periodical payments.

However, at the present time this appears to be a potentially expensive option and there is only a small market for annuities. Current providers we are aware of include AIG, Canada Life and Scottish Widows.

The discount rate for annuities is currently at about 0%, which taken in comparison with real returns on index linked gilts of 1.5% seems rather low and therefore potentially expensive when compared with an equivalent lump sum award basis. The margin between these two figures presumably covers profit, expenses and contingencies.

The annuities that are currently on the market are unlikely to meet court requirements relating to the indexation of payments. The court requires indexation at RPI for the whole of the claimant's life. Due to the difficulties of investment matching life offices are offering limited price indexation (for example a maximum inflation of 5% for any year) or only guaranteeing indexation for thirty years. It is the availability of suitable investments on the market which creates these limitations.

The longest dated index linked gilts (ILGs) on the market are 35 years at the moment although this will increase to 50 years with the future government issue of index-linked gilt maturing in 2055. With life expectancies well in excess of this, this does create a difficulty in asset matching the liabilities. There would therefore be a significant reinvestment risk after the redemption of the longest dated gilts.

Hence, with life offices unable to match assets with the liabilities represented by the annuities the products being offered are unlikely to be accepted by the courts as being reasonably secure.

#### **Self funding**

Self funding means that the insurer places aside enough funds to pay the expected periodical payments.

The three main risks in self-funding are net real investment returns, mortality and reinsurance credit risk, although these risks could be reduced by the insurer purchasing a with-profits annuity, for example. For the purposes of what follows we have ignored any reinsurance impact.

At the settlement of the periodical payment an insurer can estimate the present value of the award by discounting at a suitable investment return and applying suitable mortality assumptions.

A major benefit of annuity purchase is the removal of the administrative burden of paying a periodical payment, which includes making the regular payments and checking if the claimant is still alive, unless the insurer can find an attractively priced annuity in the market

### **Mortality Pooling**

It depends on how frequently periodical payment orders are awarded as to how many claimant lives any given insurer is covering. For all insurers the risk of reserving for an individual life is significant. The reserves are based on the best estimate and these reserves are released on death of the individual.

Therefore it may make sense for a mortality risk pooling scheme to operate for the benefit of both insurers and reinsurers.

On placing a life within the scheme each insurer would pay a premium to cover the expected lifespan and periodical payments for that award. With a large enough group of lives the level of volatility of the reserves required would be much reduced.

This would also allow central administration of the payments and annual checks on whether the claimant was still alive.

The reinsurance bad debt risk would also be reduced through pooling in comparison with the self-funded option.

Investments could also be centrally managed. In the event that there was a shortfall within the pool then additional funds would be raised in proportion to the premiums paid into the fund. Similarly, if surpluses arose then money could be rebated.

While insurers would still be holding some of the risk they would be holding a percentage of the risk of, say, 100 lives, rather than all of the risk of one life or a small number of lives.

It remains to be seen whether there is the will within the UK insurance market for a mortality pooling scheme to be set up.

## **3.5 Investment Options**

### **Restrictions of investments backing periodical payments**

General insurers do not have specific investment matching requirements, except from the perspective of generating a higher individual capital assessment. This is different from the situation with life insurers where prudential regulations require that index-linked liabilities must be covered with exactly (if possible) or closely matching assets<sup>7</sup>. While the introduction of periodical payments brings some life insurance style liabilities to general insurers, this does not bring life insurance style investment restrictions. At present there are no matching requirements for the investments that can be used to back the reserves for periodical payments.

---

<sup>7</sup> FSA's Integrated Prudential Sourcebook 4.2.58 through 4.2.60

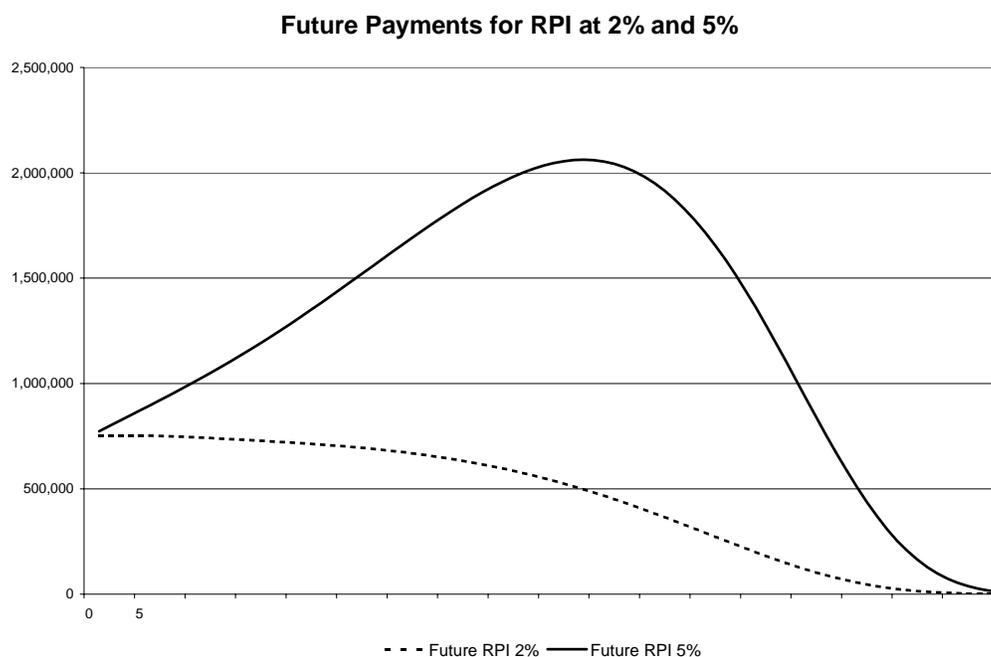
Unless an active investment strategy is being taken, with the associated risks, an investment matching strategy to mitigate the inflation and reinvestment risk will likely be the preference for most general insurers.

### Investment Matching

If an insurer is to self fund payments, one of the key questions that arises is what assets to hold in order to protect itself against changes in RPI. Ignoring the purchase of an annuity two possible alternatives are discussed by way of an example in this section.

Assume at the beginning of year 1 a company has periodical payments in place for 15 third parties, ages 10, 15, 20, ..., 80 and that mortality is in line with ELT16 projected (as used in the Ogden tables). Orders have been made for payments of £50,000 per insured per annum, rising with RPI.

The chart below shows how annual payments differ based on two different future RPI assumptions, 2% p.a. and 5% p.a.



Where payments are linked to RPI, a natural starting point is to look to the index-linked gilt market to attempt to match some of the cashflows.

The table below lists all of the current index-linked gilts in issue.

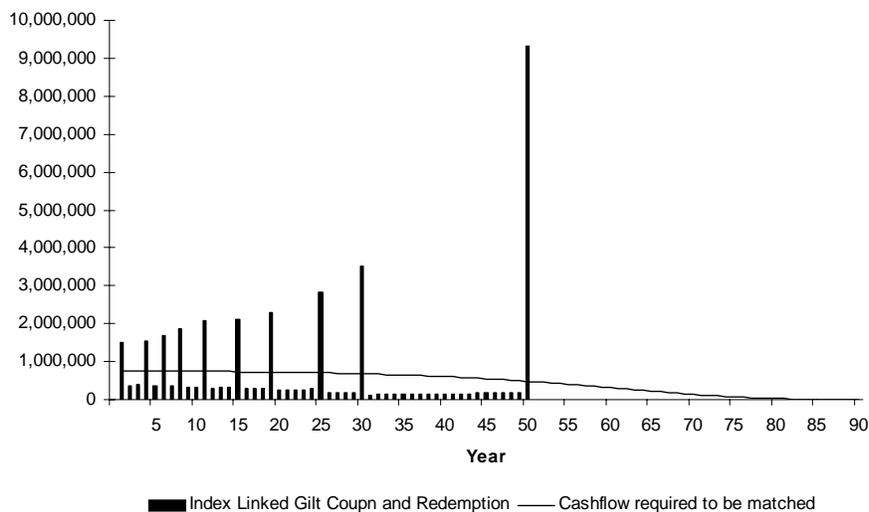
<b>UK Index-linked Gilts</b>		
Bond	Coupon	Maturity Date
2% Index-linked Treasury Stock 2006	2	19-Jul-2006
2½% Index-linked Treasury Stock 2009	2.5	20-May-2009
2½% Index-linked Treasury Stock 2011	2.5	23-Aug-2011
2½% Index-linked Treasury Stock 2013	2.5	16-Aug-2013
2½% Index-linked Treasury Stock 2016	2.5	26-Jul-2016
2½% Index-linked Treasury Stock 2020	2.5	16-Apr-2020
2½% Index-linked Treasury Stock 2024	2.5	17-Jul-2024
4% Index-linked Treasury Stock 2030	4.125	22-Jul-2030
2% Index-linked Treasury Stock 2035	2	26-Jan-2035

Source: UK Debt Management Office

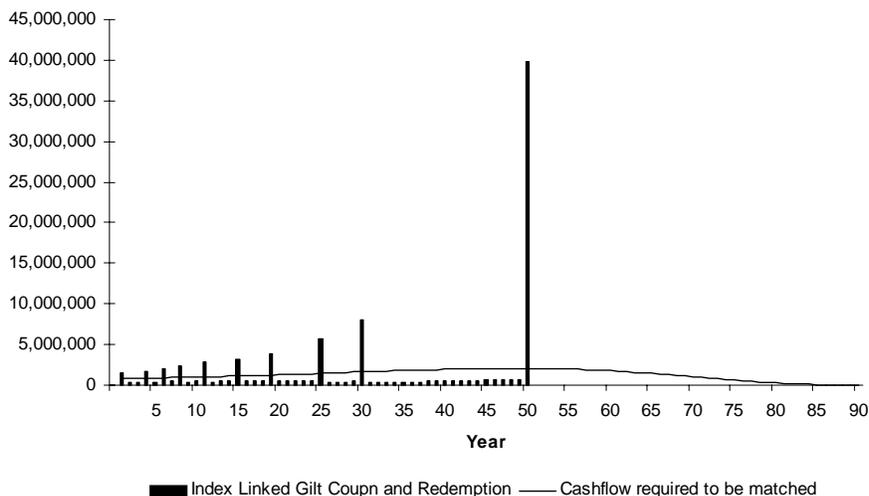
In addition to the above, the Debt Management Office has announced the issuance, in September 2005, of a new 3-month lag index-linked gilt maturing on 22 November 2055. For the sake of calculations in this example, it has been assumed this will have a 2% coupon.

The charts below show how a possible combination of these ILGs could go some way to matching the cashflows. In both cases the choice of allocation between the available ILGs is the same. Note that the vertical axes are to different scales.

### Cashflow matching – 2% Future RPI



### Cashflow matching – 5% Future RPI



It is clear that using ILGs will lead to an investment mismatch as to the limited number of ILGs available leads to peaks in the years where the gilts mature so all years are either over or under funded. There is a reinvestment risk each time a gilt reaches maturity. Further, there is no market beyond 50 years (and historically beyond 30 years).

Both of these problems can be overcome by using a combination of fixed interest gilts and inflation swaps. If the company buys a range of fixed interest gilts it is locking into a known series of cashflows. Inflation swaps exist because, in the same way that the company has access to a series of level, known cashflows, there are entities (for example backing public

sector projects) which require a flow of fixed payments, but where they will receive payments linked to RPI.

Banks can therefore structure a deal where the company enters into a series of interest rate swaps where our known cashflow is swapped with cashflows linked to RPI. Not only can the flow of coupons be swapped, but known redemption amounts can be swapped for a series of future RPI linked payments.

Further, a liquid RPI swap market exists in line with the current fixed interest gilt market, i.e. up to 50 years. Beyond this, it is also possible to structure bespoke deals up to 80 years and beyond.

There is also the potential for insurers to use mortality bonds in order to reduce the longevity risk, or to purchase annuities such as level, fixed escalation or with profits.

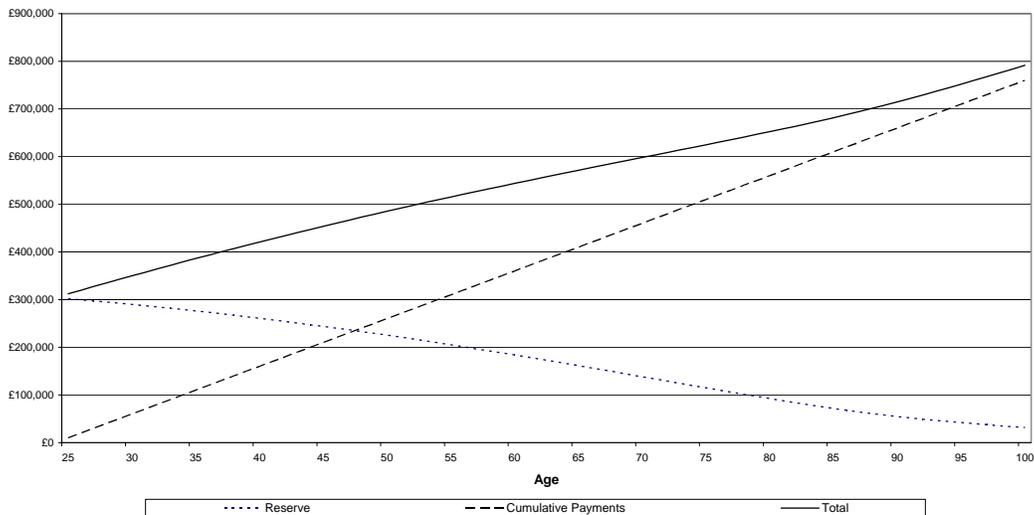
### 3.6 Reserving for Periodical Payments

After a periodical payment has been awarded a reserve needs to be set up, which involves discounting for investment returns and mortality.

On settlement of a claim the following information is needed:

- Sex of claimant
- Age of claimant
- Extent of any mortality impairment
- Annual value of payments (including frequency)
- Information on structure of payments

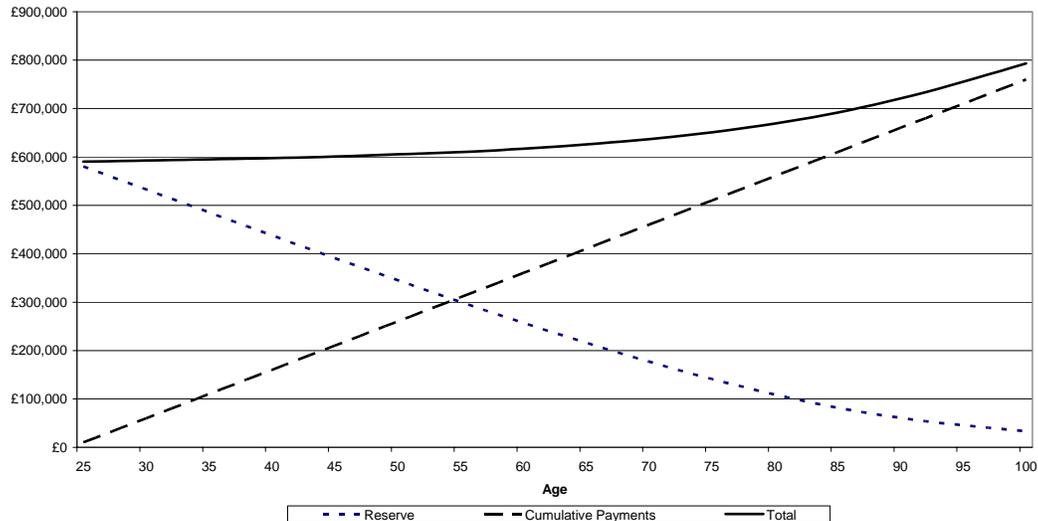
The following graph shows the reserves for a twenty-five year old male with an award of £10,000 pa discounting at 2.5% pa real and using ELT16 projected as a mortality table. For the sake of simplicity RPI is assumed to be zero.



The dotted line shows the reserves that are being held to cover future payments. The dashed line shows the cumulative payments of £10,000 a year, while the solid line shows the sum of the two.

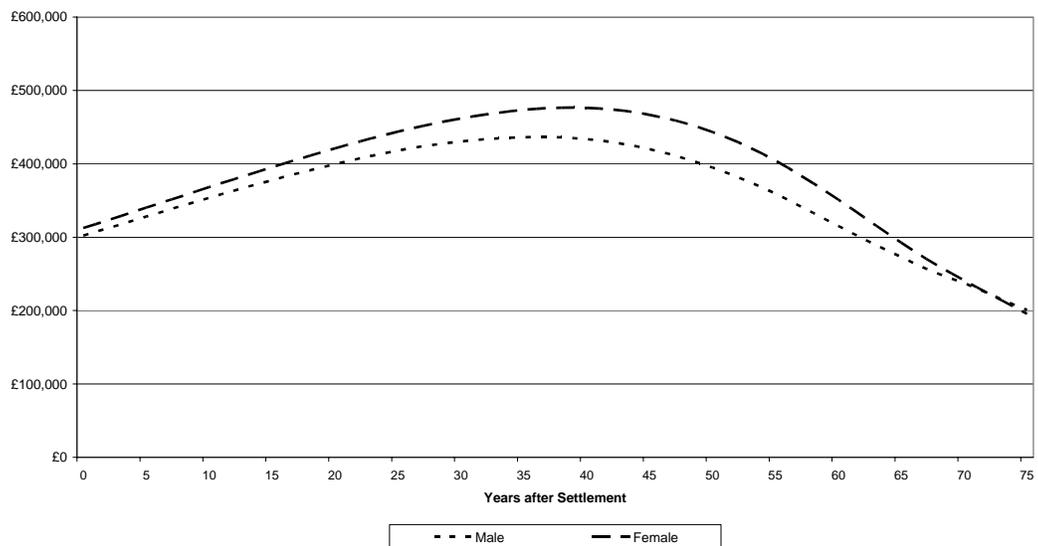
As can be seen the reserves required fall over time, but the reserves plus the cumulative payments made increases significantly. This is due to two effects. First, the assumed real investment return on the reserves, secondly the effect of mortality.

The following graph shows the effect of mortality on its own with both the discount rate and RPI inflation assumed to be zero.



As can be seen in this graph, the effect of mortality means that the reserves plus the cumulative payments rises over time, gently at first, but with significant increases beyond age 80.

The third graph shows the just the reserves that need to be held for a male and female twenty-five year old.



In these graphs it is assumed that the discount rate is 2.5% pa and mortality is ELT16 Projected. The actual reserves held would change depending on these two assumptions.

It is also worth noting that if the actual investment return is greater than the discount rate assumed then this acts to offset the reserving strain.

The reserves should also allow for an expense allowance for the cost of making the payments as well as the cost of verifying that the claimant is alive each year.

A suitable allowance should also be made for variation orders. However, the very nature of variation orders means that such an allowance is highly subjective. The two key elements would be the likelihood of a variation order being invoked and the change to the annual payments in the event they were invoked. An assumption would also be needed regarding the timing of the change in the claimant's condition although this is not as important as the other two factors.

For a self-funded insurer, the solution to this reserving strain may be to hold reserves for this single life greater than the best estimate. For a 25 year old they have a life expectancy of 54 (to the age of 83), while there is a 0.5% (or 1 in 200 years) probability of living to the age of 107. Initial reserves could be set up to cover such extreme examples which would all but remove the reserving strain, although this would mean that a release of reserves over a book of claims is to be expected over time.

It is interesting to compare the cost of an annuity with reserving at a high level. Assuming an annuity discount rate of 0% against an ILG return of 1.5% means that a 25 year old claimant would have to live beyond the age of 120 before this arrangement become profitable for the purchaser. This does ignore administration expenses and certain other issues, but nevertheless this does seem to make self-funding an attractive option in comparison with purchasing an annuity.

This effect decreases as the claimant's age increases, which means that this option would be less viable for a 50 year old. However, at that age pension annuities can be purchased in a market with far more competition and less expensive rates.

## **Mortality**

The current Ogden tables are based on the English Life Tables 16 (ELT16) with a projection for future improvement in mortality. This projected future improvement is based on the statistical improvement seen in England and Wales over the last fifty plus years.

For further information on mortality there were two excellent papers published in March and April 2005: Longevity in the 21st Century (R.C. Willets et al) and The Cohort Effect : Insights and Explanations (R.C. Willets) respectively, which examine this historical improvement.

In essence these papers examine a cohort effect, with those born in the fifteen years around 1931 having seen a substantial improvement in their mortality rates in comparison with the generation before.

This has been attributed to two factors; a healthy diet caused by World War Two and rationing and that this generation gave up smoking.

It can be easily observed that the current generation do not have such a healthy diet and for such an improvement a generation can give up smoking only once. It is not as if smoking can be given up a second time for a longevity improvement to re-occur.

A study performed by Marc Hellerstein and others at the University of California, Berkeley (published in the American Journal of Physiology, Endocrinology, and Metabolism) tested the effects of calorie intake on laboratory mice. They suggest that by reducing calorific intake lifespan is significantly increased and the risk of disease (in particular cancer) is much reduced. If one were to take their research at face value then alternate days of eating and fasting is the path to a long, if not necessarily happy, life.

The observation that life expectancy improved significantly partially as a result of rationing and restricted diet ties up well with Professor Hellerstein's work on the biological explanations for this improvement.

It is not difficult to see the change in eating habits over the last fifty years where individuals eat for pleasure rather than necessity and eating beyond the point of satiation. The impact of this on morbidity and mortality is obvious.

On the other side there are the wonder drugs and statins which lower cholesterol. Improved medical care means that individuals are far less likely to die from car accidents and cancers.

Clearly there is an element of balance between these competing factors, but the key point is that the Ogden mortality rates should not be taken as fact but that judgement is required when using them – especially for impaired lives.

This is particularly true for cases with future cost of care awards. There is likely to be an impact on future life expectancy for claimants injured in a car accident. An individual with a requirement for future care may well be paralysed or have impaired mobility. Given the role that diet and exercise plays in life expectancy an individual with impaired mobility may have a less active life (although clearly there would be exceptions).

At present a general reduction of ten or twenty years is applied to allow for this reduction in life expectancy. With the introduction of periodical payments the availability of data collection for the impact on mortality of catastrophic injury would be much increased.

### **3.7 Discounting**

Given the extremely long term nature of periodical payment claims, the ability to discount reserves will have a significant impact on the level of reserves required to be held.

The Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 (see Appendix E) contains information relating to the ability of general insurers to discount their claims provisions.

Schedule 1 - Form and Content of Accounts of Insurance Companies and Groups contains two paragraphs relating to the Provisions for claims outstanding: General business, of which paragraph 48 starts:

“ (1) Explicit discounting or deductions to take account of investment income is permitted, subject to the following conditions:  
(a) the expected average interval between the date for the settlement of claims being discounted and the accounting date shall be at least four years;”

If the average term of the business is 4 years or more then discounting is allowed. This definition is applied on a class of business basis, commonly as defined by the company. As periodical payment reserves will potentially be mixed in with the reserves for non-periodical payment claims the mean term may be under 4 years and under section 48 discounting would not be allowed.

However, there is a clause in paragraph 47 which states:

“ (6) Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose shall be calculated by recognised actuarial methods, and paragraph 48 below shall not apply to such calculations.”

This clause indicates that if a claim is paid in the form of an annuity then the reserve should be calculated using recognised actuarial methods – a term commonly found in life insurers' accounts. If we accept that a periodical payment claim is “in the form of an annuity” then discounting should be allowed.

As there has not been a full year end since the introduction of periodical payments we are not yet aware of whether this interpretation will definitely be accepted by insurance auditors. However, if the accounts are to be “true and fair” as required under IFRS4 then it is likely that discounting of periodical payments will be allowed.

### **3.8 Capital**

The Financial Services Authority's Integrated Prudential Sourcebook has introduced two new UK specific solvency capital requirements the Enhanced Capital Requirement (ECR) and the Individual Capital Assessment (ICA), in addition to the EU Minimum Capital Requirement.

The ECR is a formula based calculation which requires an insurer to multiply the balance sheet values of its assets, liabilities, and net premium income by appropriate percentage risk weights. The risk weights vary for different types of assets and according to the different classes of insurance business written by the insurer.

Firms are also required to calculate their ICA by forming a view of the risk-based capital required given the nature, scale and complexity of their business and the risks they are facing.

Periodical payment claims are expected to impact both the ECRs and ICAs of insurers.

The ECR will be affected due to its direct relationship with the size of claims reserves. Periodical payment claims, if retained by the insurer, will have the effect of increasing claims reserves. As these large claims are not paid in full, as is the case with lump sums, but are retained on insurers' books we would expect claims reserves to increase. Similarly, the insurer would retain the assets backing these additional periodical payment reserves. Assuming that there is no adjustment of the ECR factors for the introduction of periodical payments then we would expect insurers' ECRs to rise.

For ICAs we need to consider the impact on the risks faced by the insurer. As discussed above, periodical payments bring significant new risks, including the uncertainty around the initial costs and numbers, and, if they are retained by the insurer, they introduces life insurance style risks including mortality/longevity and long term investment and inflation risks. In addition, periodical payments could be expected to delay the reinsurance recoverables for most insurers, causing an increase in reinsurance credit risk exposure. We have discussed how investment matching may mitigate some of the investment and inflation risks, however significant residual risk will still remain.

Therefore, dependant on the number of claims expected and the size of the reserves attributable to periodical payments we would expect the underwriting, reserving, market and credit risks of insurers faced with paying periodical payments to increase.

Thus, for the insurers faced with periodical payment claims there is potentially an increase in solvency capital requirements.

### **3.9 Pricing**

The impact of periodical payments on pricing for both insurance and reinsurance needs to be considered.

In general, for insurers the cost impact is likely to be relatively small compared to reinsurers as it is limited to large claims which are only a small proportion of the total claims by number.

Estimates published by Watson Wyatt and EMB suggest that for direct motor the impact would be 1-2% and 2% increases respectively for total motor claims costs.

There may be additional expenses when considering the total premium impact.

However, for reinsurance, the impact is likely to be significant as the personal injury claims affected by periodical payments are also likely to have some recovery from reinsurers. This is discussed in Section 5.5.

## 4 Impact on claims management

### 4.1 Introduction

It is still very early to estimate the operational impact that the Courts Act will have on defendants and insurers. This will depend on the attitude adopted by the courts, claimants, solicitors, insurers and reinsurers.

Some may feel that the fall out from the Courts Act will reflect that of structured settlements following their introduction in Kelly v Dawes in 1989. Structured settlements were not adopted with any real enthusiasm by either claimants or defendants. Others are already taking the view that the term 'conventional settlement', which is now associated with the lump sum, top down approach will end up being associated with periodical payments (i.e. they will become the norm). As highlighted above, this is certainly the belief of the Government as made clear in Parliament during the passage of the Courts Act.

Whilst relatively few periodical payment orders have been granted to date there are many more in the pipeline and over the coming months greater numbers of cases will be settled which include periodical payments.

What has been the operational impact as insurers' claims functions deal with any early cases and prepare for the increase in periodical payments? This varies from insurer to insurer and is dependant on a number of factors including,

- The type of business written by the insurer
- The insurer's estimate of the number/proportion of their cases that could be affected
- The retention levels and wording of reinsurance contracts
- The attitude of the reinsurers to periodical payments
- How the insurers intend to fund and administer payments
- The current claims structure and systems in place
- Whether they have a life arm

### 4.2 Claims function structure

Many insurers, prior to the implementation of the Courts Act, had already centralised the handling of their large and complex losses. The vast majority of claims that is likely to be the subject of a periodical payment order should come from within this area. Any training, process or documentation changes that are required as a result of the Courts Act should impact mainly on the large personal injury loss handlers and processes.

Those insurers who have not centralised the handling of their large losses may look to concentrate any claims with periodical payment potential with a few handlers, in the short term, to assist monitoring and ensure a consistent approach.

### 4.3 Claims function systems

Claims IT systems may well require enhancement to be able to cope with the extra demands placed on them by the need to reserve for and administer periodical payments. Additional management information may also be required to monitor the volume and value of cases with periodical payments and any impact on non periodical payment settlements. Reinsurers may also have additional reporting requirements.

The level of system change will depend on the functionality of the current systems and whether the insurer is looking to self fund, purchase an annuity or a combination of the two.

For the self funding option, the decision whether to outsource any claims payment administration or keep this processing in house will also have a bearing on system requirements.

Whilst the numbers of periodical payments are low, many insurers may well self fund (especially if they are unable to purchase an annuity from within their own group) and administer the payments manually in house, or use a third party administration service. As the number and variety of periodical payment orders increase and if further providers of life annuities enter the market, insurers may revisit their approach and the system enhancements required.

Third party administration services, as well as administering the insurer's periodical payment orders, may well provide other related services, including monitoring the status of the claimant and estimating case reserves.

#### **4.4 Case estimates**

Insurers will look to undertake reviews and put procedures in place to assess the impact that periodical payments have on their case estimates and the settlement values. As the provisions of the Act apply to all personal injury cases outstanding or reported on or after 1 April 2005, the volumes and values of cases that might be affected could be significant. An assessment of the depth of review of outstanding claims and the approach to take on new claims will be required.

Some insurers are using set criteria to estimate the likelihood of a periodical payment. The criteria will typically include the following:

- Any element of future pecuniary loss
- The types of claimant e.g. minors
- The future loss estimate – size of the claim and size/uncertainty in life expectancy
- The level of certainty on liability, any contributory negligence and causation

Having taken a view as to the likelihood of a periodical payment an appropriate uplift may then be applied to the 'conventional reserve' either to the individual claim or on a bulk/IBNR basis.

Some insurers in our survey, covered in detail in Section 7, have indicated that they are already or are intending to put through bulk adjustments. A number of different approaches have been reported including bulk case estimate adjustments based on the probability of large claims settling as periodical payments and the estimated increased cost, IBNR adjustments, and waiting until cases are identified before making any allowance.

#### **4.5 Variation of periodical payments**

As variable orders apply only to cases issued on or after 1 April 2005 it is very doubtful that many variable orders will have yet been granted. The DCA guidance makes it clear that the scope for variation would be tightly controlled and in the majority of cases a non-variable award is likely to be appropriate. The extent to which variable orders will be made by the courts is as yet uncertain, as is the effect that variation will have on the length of the 'claims tail' and therefore premiums.

Insurers will also have to consider their strategy where a variation order applies as to how and when to check any deterioration or improvement in the claimant's condition. A starting point here might be the approach taken by permanent health insurers, where some variation in payment is possible.

It will be interesting to observe what effect periodical payments and variation orders have on insurers' rehabilitation programs. Arguably, for a periodical payment with a variation order,

the insurer should be proactive in trying to rehabilitate the claimant. Conversely, for a periodical payment without a variation order (i.e. the future payments are effectively fixed in line with RPI), the insurer may be less proactive in rehabilitating the claimant.

Where the court makes a variable order, insurers and legal representatives are required to preserve case file documents to ensure that any subsequent application can be dealt with effectively and without unnecessary costs.

#### **4.6 Involvement of reinsurers**

The extent to which reinsurers will wish to become involved in the handling of a case by the cedant will vary from reinsurer to reinsurer but will be broadly driven by the level of retention and therefore exposure to the reinsurer and the wording of any claims cooperation clause. Due to the lack of historical data and uncertainty as to the effects of the Courts Act cedants with low to medium retentions are finding that reinsurers, lead and follow, wish to have a greater involvement where periodical payment emerges as an issue.

#### **4.7 Settlement strategy**

Insurers may review their settlement strategies to consider whether there are any circumstances where they may look to actively encourage a periodical payment or how they will react where a claimant advises that periodical payments are being sought.

If insurers identify that certain types of cases are likely to attract periodical payment orders and that, for these cases, they are experiencing significant claims inflation, which for larger claims many are predicting. Then they are likely to review their settlement strategy to determine whether settling the claims earlier in the process, perhaps pre-litigation or without court intervention, may lead to reduced claims inflation.

There are anecdotal reports of claimants attempting to increase lump sum awards on the basis that they will pursue a periodical payment order if the increase is not agreed to. However, generally insurers are not reporting identified increases in the settlement cost of claims settled in the conventional lump sum manner.

There is a perception that a large number of claimants do not want periodical payments. They want their lump sum 'windfall' straight away so they can do what they want with it and should there be any excess at the time of death the claimant's estate benefits. This may lead to an increased desire to settle pre-Court.

Insurers may attempt to use this position to reduce lump sum awards on the basis that the claimant would prefer a lump sum.

However, should the case go to Court, whilst the Court will take into account the form of award preferred by the claimant and the defendant, it is the claimant's needs, not their wishes, which are paramount.

#### **4.8 Part 36 offers**

A Part 36 offer (which refers to Section 36 of the Civil Procedure Rules) is an offer to settle the claim before a judgement is made in court and can be made by either the defendant or the claimant. If a Part 36 offer made by the defendant is rejected by the claimant and the claim ultimately settles for less than the offer, either by agreement or through the court, then the defendant will have to pay additional costs and perhaps interest. Similarly, the defendant can also make a Part 36 offer with the same potential penalties for the claimant.

The aim of these rules is to reduce the need to go to court and the costs this implies and to encourage early settlement of claims. The claimant receives their compensations sooner without the ordeal of having to prepare for trial and appear in court and both sides benefit from reduced legal costs.

Amendments have been made to the Civil Procedures Rules to ensure that this scheme also works with periodical payments. The rules include the requirement for part 36 offers to be clear as to the amount of any lump sum and the amount and duration of the periodical payments. The complication is that if a combination of a periodical payment and a lump sum is offered as a Part 36, then it is not clear whether any subsequent settlement betters this offer. The settlement may be on a different combination of periodical payment and lump sum

Insurers may also wish to undertake a review of their existing Part 36 offers or payments into court on cases where they feel there is a likelihood of a periodical payment being agreed or ordered to assess the appropriateness of the existing offers. If a court is likely to impose a periodical payment then a Part 36 offer of a lump sum may not be appropriate.

However, overall it is believed that Part 36 orders will be decided in favour of the claimant unless it is obvious that the periodical payment order is less favourable than the Part 36 offer.

## 5 Reinsurer specific issues

### 5.1 Reinsurance

As periodical payment orders are likely to be awarded to large bodily injury claims, which may be recoverable under a reinsurance excess of loss contract, reinsurers will deal with a relatively higher proportion of periodical payment claims than the primary insurers. The cost impact of the Courts Act on reinsurers is unknown but any increase in claims severity will have a “gearing up” effect to the cost of providing excess of loss cover. Reinsurers will also have to carry new risks such as payment timing risk and investment risk. The administrative cost of handling these claims is also likely to be higher. This is assuming that reinsurance coverage and conditions would be as they were before the introduction of periodical payments.

Obviously, the introduction of periodical payment orders triggered reactions and new requests over coverage conditions from London Market reinsurance brokers and underwriters. This was mainly formalised by the International Underwriting Association who changed the contents of the Standard Market Questionnaire for Motor and Employers Liability reinsurance submissions. It also issued some guidance as to how to adapt generic London Market wordings for motor excess of loss treaty reinsurance as a consequence of the Courts Act 2003. However, clauses used in practice in the market are extremely varied, and are largely tailored to suit the requirements of individual reinsurers and their clients. In addition, there is exposure to periodical payments orders under outstanding claims covered by 2004 or prior reinsurance contracts, the terms of which did not anticipate the introduction of periodical payments.

### 5.2 Attachment & indexation of reinsurance policies

General terms require the reinsured to notify their reinsurers if any claim is likely to contain a periodical payment, irrespective of the reporting threshold trigger. The ongoing obligation under a reinsurance treaty is to report a claim after settlement and before any breach of retention but the extended duration of a periodical payment claim means reporting could be considerably delayed assuming the reinsured has self-funded. The loss estimate must be reported on a gross and undiscounted basis.

As a general rule, the reinsured does not have a basis to make a claim until the amount of the periodical payments and other associated claims costs paid breach the deductible. However, in case of self-funding by the reinsured, it is still under consideration as to whether periodical payments claims can be recovered from reinsurers before the treaty retention is breached (accelerated payment).

The current stability clause under a reinsurance treaty allows for an indexation of the treaty attachment point in the case of continuing regular payments. Different indexation dates would apply depending if the payments are aggregated or treated separately. An indexation of the aggregated payments at the final date of payment, which is in line with current market practice, would apply only in the case of purchase of an annuity prior to the commencement of continuing regular payments.

In all other cases, which include Provisional Damages, indexation of the retention at each separate payment date of payment would apply (in case of more frequent than annual payments, either the date of commencement or the mid-point of each 12 months period would be considered the date of payment for indexation purposes). Common market practice for index clauses is that the limits are indexed based on a weighted average of the future nominal payment amounts and the index value at that time. A general market approach is that each payment should be adjusted as follows:

$$\text{Adjusted payment amount} = \frac{\text{Amount of payment} \times \text{Base Index}}{\text{Index for the period}}$$

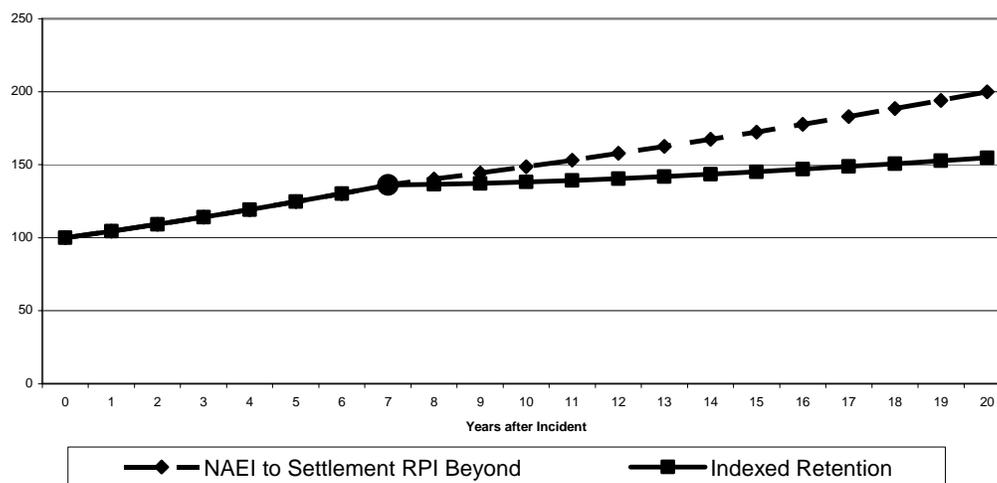
The retention and the limit are then multiplied by:

$$\frac{\text{Total of payment}}{\text{Total of adjusted payment amounts}}$$

Thus the limits are not fully adjusted to the new payment date as this would cause an erosion of all previous recoveries achieved under the contract.

There may also be uncertainty as to the index to be used. The reinsurance market has traditionally used the index which is referred to as “non-seasonally adjusted” as opposed to the recently available “seasonally adjusted” figures which would give fairer and more consistent figures. For the case of periodical payments it is likely that there are no significant issues around indexation, if the reinsurance contract contains the common wording “In respect of an award resulting in continuing regular payments the index or indices to be applied shall be that for which an award is linked, and for all other payments the index to be applied shall be: ... ‘Average earnings of all employees for whole economy’”,

The following chart shows the indexation of a deductible at wage inflation between the incident and settlement and that applied beyond this. This is compared with RPI indexation.



As can be seen the indexation of the retention increases at a lower rate than RPI.

This is the case for a single life. The valuation of multiple lives under the same claim may cause difficulties for the indexation of limits and retentions and valuation of the reserves.

### 5.3 Claims settlements & capitalisation

Independently of the way the reinsured funds the original claims, the reinsurers will have to use a similar course of action to fund and settle periodical claims retroceded. Thus if the reinsured purchases an annuity this will also result in an initial cash outlay for the reinsurer. However if the reinsured self-funds the reinsurance payments will also be spread over the life of the claim if not capitalised.

According to the generic claims co-operation clause under a reinsurance treaty, the insurer has to ensure that any choice of settlement, such as the purchase of an annuity or augmented lump sum payment to settle the claim, is considered beneficial or expedient to both primary insurer and reinsurer. There is a risk that direct insurers could settle claims on an uneconomic basis, either by purchasing an annuity from an uncompetitive market or purchasing an annuity from a sister life company, in order to generate an immediate recovery and remove the claim from their books. Reinsurers may therefore want to add a clause to the treaty to be able to exercise more control on the claim settlement.

The settlement and funding of periodical payment claims will increase the administrative burden on insurers and more of the administration may be outsourced to third-parties. This poses the issue of recoverable elements under a reinsurance treaty. Office expenses incurred internally by a direct insurer whilst administering periodical payments are not a recoverable expense, but outsourced services to third parties may usually be claimed from reinsurers. A particular scenario is if the reinsured opts for the purchase of an annuity from its own life arm. The ultimate net loss clause may have to be adapted to specify the profit element and expenses to be recovered under the treaty in this case, if the reinsurer explicitly wants to exclude payments for expenses under this scenario.

Further to the usual choices open to insurers, an alternative settlement option open to reinsurers is per original claimant capitalisation: a lump sum is paid by reinsurers to the reinsured to discharge the reinsurer's liability on a discounted value basis for a given claimant. This is opposed to a commutation where all liability is discharged for the entire policy. Capitalisation could be an effective tool for reinsurers to manage their exposure to periodical payments, whilst providing the reinsured with an immediate cash flow which they can invest to meet the future periodical payments.

Such capitalisation should be by individual claimant as opposed to per loss occurrence to be consistent with courts orders which are on a per claimant basis.

#### **5.4 Variation order**

Periodical payment orders may only vary if the court provided for the possibility of variation in the original order and if there is a significant change in medical condition which could be foreseen at the time of the original order.

The variation order allows the periodical payment to either increase or decrease. Although it is expected that most reviews will result in an increase in payments for the reinsurer and the reinsured, it is also possible that the claim amount could be reduced if the claimant shows signs of improvement in his or her health. Clauses to cater for this eventuality need to be negotiated individually between reinsurers and reinsureds. They potentially should allow the reinsurer to claim money back from the reinsured in the case of a future decrease.

Reinsurance clauses would generally apply to reinsurers claims payments following a variation order under the same conditions as in the case of self-funding by the reinsured.

#### **5.5 Effect on pricing**

As discussed in Section 5.2 above, indexation of the reinsurance retention makes the valuation of claims from the reinsurers' point of view less than straightforward. For periodical payments that increase at RPI the IUA indexation clause increases retentions at a rate less than RPI. This means that once the retention is breached the reinsurer pays a larger and larger proportion of each payment, but this never reaches 100%.

Assuming that the Courts Act will increase the original claims cost, the expected increase in settlement amounts will have a gearing up effect on the reinsurance as more losses will reach the reinsurance thresholds and Periodical Payments will affect a relatively higher proportion of high severity claims.

This expected increase is likely to be very sensitive to:

- The retention limit
- The difference between the Ogden discount rate and the real discount rate
- The expected mortality and mortality improvement assumptions used
- The frequency and size of claims affected by periodical payments

Courts awards are calculated for a number of heads of damage which are added together. Future cost of care, future loss of earnings and pension are all head of damages which depend on the expected life expectancy and therefore the Ogden table used and the corresponding indexation currently embedded in the assumed real yield of 2.5% p.a. net of tax.

Where a claim is self funded, and dependent on the size of the associated lump sum component of the claim, it may take years for the periodical payments to breach the reinsurance retention.

A key difference between lump sum awards and periodical payments is that a lump sum award is based on average assumptions whereas periodical payments ultimate costs are uncertain, potentially highly when considering an individual case.

The technical pricing will also have to allow for an additional volatility loading corresponding to the uncertainty in the value of the key parameters driving the final loss cost.

Hence the impact on reinsurers is therefore even more uncertain than the impact on direct insurers. Pricing, due to the uncertainties highlighted above, potentially raises the most significant difficulties for reinsurers.

## 6 Financial Impact - Modelling the impact of periodical payments (verses lump sum awards)

### 6.1 Introduction

Currently when setting a conventional lump sum award, the multiplier is assessed using the latest Ogden tables and an assumed discount rate of 2.5% p.a. This discount rate is an estimated net 'real' discount rate (i.e. it is an estimate of the rate of return net of tax in excess of RPI that the injured party could earn on their investments if invested safely).

Under a periodical payment award, whether purchasing an annuity or self funding, claim costs are likely to increase. The anticipated change in claims costs is driven by:

- Exposure to lower real expected yields (if backed by safer investments such as index linked gilts) or exposure to higher real expected yields (if backed by riskier investments such as equities)
- Exposure to future improvements in mortality (over and above that currently allowed for within the current Ogden tables)
- Additional administration expenses
- Profit loading (for annuities if purchased)
- Reduced reinsurance protection, resulting from the continuing indexation of the retention in line with the regular payments and the increased exposure to reinsurance bad debts due to the increased payment delays (if self funding and the claims are not capitalised)

The anticipated change in reinsurance claim costs as a result of periodical payments is highly sensitive to the following assumptions:

- The proportion and value of cases which will be subject to periodical payments orders
- The difference between the assumed net real yield and the Ogden discount rate, (the former of which will need to be adjusted to allow for the reinvestment risk, given any potential mismatch between the liabilities and available assets)
- Expected changes in mortality

In addition, when estimating the change in the net of reinsurance claims costs, the reduced reinsurance recoveries (from the continuing indexation of the retention) and the potential increase in reinsurance bad debts needs to be considered.

### 6.2 Individual claims impact

The table below shows the potential impact of a periodical payment award. Unless stated otherwise the base risk is assumed to be for a 40 year old male claimant, which is settled after 7 years for approximately twice the reinsurance retention (initially set at £1m). The periodical payment was inflated assuming RPI of 3% p.a. The reinsurance retention was inflated at NAEI of 4.5% p.a., before settlement and RPI thereafter (in accordance with the indexation described in Section 5.2). The payments were discounted at a real rate of 1.5% p.a. and we used the ELT16 mortality table allowing for future improvements.

	Claim Amount (sensitivity by size)			Claim Amount (sensitivity by age)		
	1 x Retn	Base (2xRetn)	4x Retn	25	Base (40)	55
Discounted gross retained loss - conventional	759,416	1,500,461	2,982,550	1,699,666	1,500,461	1,225,011
Discounted gross retained loss - periodical payments	814,256	1,610,142	3,201,913	1,961,621	1,610,142	1,210,314
% Increase	7%	7%	7%	15%	7%	-1%
Discounted reinsurer's retained loss - conventional	-	500,461	1,982,550	699,666	500,461	225,011
Discounted reinsurer's retained loss - periodical payments	35,103	522,178	1,960,261	792,698	522,178	240,429
% Increase	na	4%	-1%	13%	4%	7%
Discounted net retained loss - conventional	759,416	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Discounted net retained loss - periodical payments	779,153	1,087,964	1,241,651	1,168,923	1,087,964	969,884
% Increase	3%	9%	24%	17%	9%	-3%
	Claim Amount (sensitivity by settlement delay)			Claim Amount (sensitivity by real discount rate)		
	2 Years	Base (7 years)	12 Years	2.5%	Base (1.5%)	0.5%
Discounted gross retained loss - conventional	1,869,847	1,500,461	1,204,046	1,403,691	1,500,461	1,604,930
Discounted gross retained loss - periodical payments	2,149,450	1,610,142	1,197,058	1,334,696	1,610,142	1,977,897
% Increase	15%	7%	-1%	-5%	7%	23%
Discounted reinsurer's retained loss - conventional	869,847	500,461	204,046	468,184	500,461	535,305
Discounted reinsurer's retained loss - periodical payments	967,625	522,178	226,270	379,435	522,178	726,661
% Increase	11%	4%	11%	-19%	4%	36%
Discounted net retained loss - conventional	1,000,000	1,000,000	1,000,000	935,507	1,000,000	1,069,625
Discounted net retained loss - periodical payments	1,181,825	1,087,964	970,788	955,261	1,087,964	1,251,236
% Increase	18%	9%	-3%	2%	9%	17%

As can be seen from the above table, the base example (40 year old claimant, settled after 7 years, discount rate of 1.5% p.a. real, lump sum equivalent of twice the retention) the gross retained loss is 7% greater (net is 9% greater) than the equivalent lump sum. These percentages increase as the real discount rate decreases.

The table also demonstrates that the increase in the retained loss is very sensitive to changes in the base assumptions, and in particular to the size of the claim, age of the claimant, the settlement delay and the real discount rate.

Some similar figures, courtesy of Anthony Carus, indicate that the expected increase in reserve required to be held (which varies by head of damage, age and prudence of reserving basis – see Appendix G for details) for a 40 year old male are 31% (care costs), 16% (loss of earnings) and 68% (loss of pension), on a typical reserving basis.

It is interesting to compare these figures with the implied change in the Ogden discount rates necessary to bring about a similar change.

Using the ELT16 mortality table, discounted at a real rate of 2.5% p.a., as used by Chris Daykin at the “From Lump Sums to Periodic Payments and Beyond” seminar held at Staple Inn in March, the Ogden multipliers, and implied uplift is highlighted in the table below:

<b>Comparison of Ogden Multipliers</b>			
	Male aged 25	Male aged 40	Male aged 55
Ogden Multipliers at X%			
<b>2.5% Real Discount Rate</b>	30.13	25.62	19.37
<b>2.0% Real Discount Rate</b>	33.78	28.08	20.72
% increase (cf 2.5%)	12%	10%	7%
<b>1.5% Real Discount Rate</b>	38.17	30.95	22.23
% increase (cf 2.5%)	27%	21%	15%
<b>1.0% Real Discount Rate</b>	43.49	34.29	23.93
% increase (cf 2.5%)	44%	34%	24%
<b>0.5% Real Discount Rate</b>	50.00	38.20	25.83
% increase (cf 2.5%)	66%	49%	33%
<b>0.0% Real Discount Rate</b>	58.02	42.81	27.97
% increase (cf 2.5%)	93%	67%	44%

By comparing the above two tables, it can be seen that the increases in the net retained loss is “equivalent” to a reduction in the real discount rate of up to 1.0%, depending on size of claim, age of the claimant, settlement delay and real discount rate.

### 6.3 Assessment of the increase in claims costs

We examined the increase in gross outstanding claims reserves for a standard motor portfolio using a range of assumptions for the following:

- the proportion of claims impacted by periodical payments (proportions varying overall and by claim size within that)
- future real yields
- future improvements in mortality

The increase in gross outstanding claims costs as a result of periodical payments based on this broad range of assumptions was between 1% and 7%, although some of these assumptions were fairly optimistic or pessimistic.

This compares to the estimated increase in outstanding motor gross claims costs due to a 1% reduction in the Ogden discount rate of around 4% to 6%.

Similar analysis on a basket of large motor and liability claims, suggests an increase in the claims cost due to a 1% reduction in the Ogden discount rate of around 3% to 4% (gross), 1% to 3% (net) and 5% to 15% (for reinsurers).

Obviously the reinsurance figures vary significantly depending on assumed retention levels. However, the figures above highlight the potential gearing of the increase for reinsurers.

A number of estimates have been produced to consider the impact of periodical payments on personal lines claims costs.

Watson Wyatt have suggested that the introduction of periodical payments could increase total gross outstanding motor claims reserves by 3-5%, although the net of reinsurance increase would be lower, (but with the possibility of a significant increase in reinsurance credit risk).

In terms of the future impact, Watson Wyatt suggested that the increase in total gross motor claims costs going forward could be 1-2%.

A case study produced by Watson Wyatt based on a £2.5 million reinsurance retention suggested a possible increase in the range of 25-75% for the total reinsurance claim costs if the total gross claim costs increased by 1-2% (including property damage).

EMB have suggested that the likely claim cost increases for motor would be around 5% for personal injury claims and approximately 2% overall.

## **7 Survey results**

### **7.1 Introduction**

In order to investigate the current market situation with respect to periodical payment claims, and insurers' current responses, we have carried out an informal survey of direct insurers. As there have been very few periodical payment claims to date, and as details of settlements are commonly not made public, we have used the survey to understand the actual level of claims. We have also surveyed insurers regarding their preparations including systems changes required, reinsurance issues and discussions and their intended funding approaches. Finally we asked insurers whether they had seen any cost impacts to date, whether they anticipated any cost impacts and how they intended to reserve for periodical payment claims both in case estimates and IBNR adjustments.

### **7.2 Basis of the survey**

The survey has been carried out on an informal basis, with participants being emailed the survey and responding back by email. As such, the responses collected were not anonymous; however no information identifying the participants or their individual information has been included in this report.

The insurers surveyed were chosen to represent a range of different types of insurers, from large to small, Lloyd's and company market and from those focussed on writing motor business to those writing a diversified book. In total 9 insurers have responded to the survey to date.

As such the survey is intended to provide a general view of the current state of the market. It is not intended to represent a comprehensive information gathering exercise across all affected insurers.

We note that there is currently no mechanism for collating industry wide information on the numbers, amounts or details of periodical payment claims. The Working Party would welcome feedback from affected insurers to understand if they would see benefit in a future survey after more claims have been settled.

### **7.3 Survey results**

#### **Classes affected**

Motor, Employers' Liability and Public Liability were the classes particularly identified. Many respondents stated that they believed that periodical payment claims would be possible in all liability classes. One respondent went further saying that they expected these claims to be most likely "on any liability risk particularly where you are dealing with a minor or patient, where there is little or no contributory negligence and there are life expectancy issues."

#### **Claims to date**

Very few claims to date have been settled as periodical payments. Of the 9 insurers surveyed 2 have settled one periodical payment claim each, with the remaining 7 having settled none.

Four insurers have had at least one periodical payment claim mooted or pleaded against them, including those settled above with a total of 5 claims mooted or pleaded and currently outstanding. This totals 7 claims between 9 insurers meaning that we expect that many that insurers will still not have seen a periodical payment claim even mooted by claimant solicitors.

#### **Funding**

Insurer responses to the question of how they were intending to deal with periodical payment claims were a mixture of self fund, purchase annuities on market or purchase annuities from their own life company.

For the insurers without life arms about half are intending to retain the claims leaving half with the preferred option of purchasing annuities on market.

For insurers with life arms some preferred to retain the claims to maintain flexibility, and others to retain or transfer based on the cost of transferring, including purchasing an annuity on market if this was an economic option. None indicated a strong preference of using their life arms.

Most of the insurers did state that they were currently still investigating all of the options available, however there was no clear market preference exhibited.

## **Systems**

Claims and payment systems changes are potentially required to allow for periodical payments. Of our 9 insurers only 2 indicated that they would definitely need to make systems changes. One insurer indicated that they would need to make changes if they decided in future to retain claims. Another insurer is currently intending to use a spreadsheet based process.

When asked whether the regular payments would be made in-house or outsourced the insurers responding were relatively evenly split. Outsourcing was a preferred option for some as this allowed for finality and for some as this allowed for simplification of the payment process, with payments only being required to be made in aggregate once a year.

## **Reinsurance**

Only one insurer stated that they had carried out negotiations with their reinsurers and that they had solved all their reinsurance issues. Most insurers have started negotiations and one expects to resolve the issues over the next few months. Insurers surveyed highlighted the main issues as being:

- Capitalisation clauses – Some reinsurers are looking to introduce mandatory capitalisation clauses whereas others want to be able to discuss capitalisation on a case by case basis
- Administration costs – If an annuity is purchased then the reinsurer will implicitly be meeting the administration expenses, however if the periodical payment is self funded then the insurer will be meeting these costs
- Cooperation clauses – What is the level of involvement that reinsurers require and when do they need to be notified

All insurers responding indicated that contract wordings had changed or would have to change for 2005.

In respect of reinsurer involvement the general response was that increased involvement was expected, but not much had been seen yet. Insurers expected greater involvement if reinsurers believed that purchasing annuities was an expensive option and one insurer indicated that they would “involve reinsurers as far as practical in settlement negotiations”.

## **Cost impact**

Around half of respondents believed that periodical payments claims would cause an increase in claims inflation with a further few indicating that it was still too early to determine or quantify the impact. Two insurers indicated that they believed that there would be a neutral cost result, with one stating that “The clear intention of the PP legislation during consultation was that it should be broadly cost-neutral”.

Insurers generally believe that there would not be a cost impact on non-periodical payment claims, however two insurers were concerned that periodical payments could be used as a

negotiating ploy to increase lump sum payments, and another was concerned that the Ogden rate may move to a more market based discount rate, causing a direct increase in lump sum awards.

### **Reserving**

Some insurers have already or are intending to put through a bulk case estimate adjustment. One approach stated is to assume a probability of large claims settling as a periodical payments and then having the bulk adjustment calculated considering the increased cost assumed for periodical payments. Other insurers are putting adjustments through their IBNR provision, or are waiting until periodical payments claims have been identified before making provision.

Once a periodical payment has been agreed then insurers indicated that they are intending to use either life valuation techniques, allowing for discounting and future mortality, or market annuity quotes in order to set case estimates for these individual claims. One discussed including an appropriate prudential margin to allow for longevity risk and another indicated that a life underwriter with impaired life expectancy experience would be involved.

Four insurers have already put through IBNR reserve adjustments to recognise the increased costs and others are intending to review the situation prior to year end.

## **7.4 Summary**

Overall, the survey indicates that claims have not yet come through in large numbers. Approaches are varying significantly between insurers, who are still in the process of making preparation for these claims.

As stated above, the Working Party would welcome feedback as to whether a future, more numerical, survey would be of benefit to affected insurers.

## 8 International perspective

As part of our research we have considered what we can learn from the periodical payment experiences of other countries.

The Department of Constitutional Affairs (“DCA”) undertook research in this area as part of the consultation process in developing legislation and presented this in their paper “Damages For Future Loss: Giving the Courts the Power to Order Periodical Payments for Future Loss and Care Costs in Personal Injury Cases” dated March 2002<sup>8</sup>. Below we have collated their information on the international perspective and supplemented this with our own research.

We have provided an overview of the use of periodical payments for personal injury awards in Australia, Sweden, Germany, United States, France, Spain, Canada, Austria, Belgium, Finland, Greece, Holland, Portugal, Ireland, Italy and Luxembourg. We also discuss the experiences of insurers in some of these countries in dealing with periodical payments in terms of the implications for claims management, case estimation, reserving and reinsurance.

### 8.1 Summary by Country

#### Australia

Periodical payments have been in place in Australia since the early 1900s with the introduction of Workers’ compensation legislation. Workers’ compensation systems are state operated and vary by state but commonly involve multiple insurers, with insurer involvement ranging from claims management only through to taking underwriting risk.

Periodical payments are used for both short term conditions where claims are expected to recover or return to work and the permanently disabled.

Australia is currently considering the introduction of a national no-fault long term care scheme for injury victims. As part of a reform process they are considering making cost of care payments directly to service providers rather than to the claimant.

#### Sweden

In the Swedish system the use of periodical payments for future loss of income is preferred, and the court has the power to order them even if both parties do not agree.

Health care costs are not covered as these are provided by the State.

Where compensation for loss of income or other financial support is provided under a life annuity, it can be increased or reduced if the conditions that determined the compensation have changed considerably. If the compensation was paid in a lump sum, supplementary compensation may be awarded to the person suffering the loss.

Experience to date suggests that revisions are far more likely to be increases rather than reductions. The impact is that claims development triangles show very long term development and this increases the uncertainty inherent with any reserve estimate.

#### Germany

In Germany insurance annuities are common for motor, accident and general liability injury claims, covering cost of care, rehabilitation costs and loss of earnings. Review is available where the claimant’s condition has deteriorated. Lump sum payments are used, however only when both insurer and claimant agree.

#### United States of America

---

<sup>8</sup> <http://www.dca.gov.uk/consult/general/periodpay.htm>

Structured settlements were first recognised in Federal law in the USA in 1982 when a tax break was introduced for payments from an annuity funding a structured settlement. In most States, the courts do not have power to impose structured payments on claimants or defendants. Courts in a few States do have that power. In California, for example, the court has the power to order structured payments in all cases where the future damages exceed \$50,000.

Structured settlements are awarded in cases of temporary or permanent disability, cases involving minors or mental incompetents, workers compensation, wrongful death payments to spouses/children and severe injury with long-term needs for medical treatments.

Workers compensation is the fastest growing line for the use of structured settlements. The use of structured settlements has been quite successful in the US in terms of getting claim payments closer to actual damages and in encouraging out of court settlements.

There has also been substantial debate in the last few years about the issue of factoring. The factoring market grew rapidly in the late 1990s leading to the formation of a National Association of Settlement Purchasers (NASP). The NASP argued that the ability to factor all or part of the future payments under an annuity added a valuable element of flexibility, particularly where the claimant's circumstances changed unexpectedly. Opposition to factoring has been led by the National Structured Settlement Trade Association (NSSTA).

They argued that factors often bought the annuity for substantially less than its current market value, sometimes as little as 40-50%.

Starting with Illinois in 1997, a number of States have enacted consumer protection to control factoring. In April 2001, the NSAP and NSSTA reached an agreement about regulating the situation on the basis of legislation at both State and Federal level. The model State legislation provides for disclosure by the factoring company of all costs, discount rates and fees, and requires that a court must find the transaction "in the best interests of the claimant". As of December 2001, 30 states had passed laws of this nature, with more pending. The Federal legislation, currently before Congress, provides for a 40% excise tax on deals that do not comply with State model laws. There will be an 18 month grace period before this takes effect to allow other States time to pass the necessary legislation.

## **France**

In France the court is responsible for fixing the amount of damages for personal injury cases, taking into account (although not necessarily following) what the victim claims. In cases involving accidents at work, the social security authorities are responsible for fixing the amount of damages to be awarded.

Payments of personal injury compensation can be made in a lump sum, or in a series of payments. The court decides which method of payment is suitable, and the decision does not necessarily reflect the wishes of the claimant (although their preference would be known). This decision can be appealed in a higher court.

Reviews are allowed if the claimant's condition deteriorates and this is becoming increasing common. Reductions are not allowed once a settlement has been reached.

Costs of care awards are commonly made in a series of payments to ensure that the claimant receives money for treatment.

Loss of earnings is commonly paid in a lump sum, the amount being equal to the mathematical annuity reserve (present value of annual wage multiplied by expected length of life).

On death of the claimant a temporary annuity can be paid to children until the age of 20.

## **Spain**

The Spanish system allows for damages to be paid as lump sums or periodical payments. The courts have the power to order either system of payment and they decide on the basis of the ability of the defendant to pay and the needs of the claimant. Neither of the parties has to agree to the system of payment.

Periodical payments have been an option for many years in Spain but companies usually try to reach an agreement with beneficiaries in order to avoid them. Courts tend to award periodical payments to young beneficiaries with a high or total disability.

### **Canada**

In Canada, the courts have power to impose structured payments in Ontario, Manitoba, Saskatchewan, Quebec (in respect of minors only), and British Columbia (in respect of motor accident cases). In Ontario, there is a statutory presumption in favour of periodical payments, but this is often rebutted in practice. In other Provinces, structured payments require the consent of the parties.

### **Austria**

A structured settlement system has evolved in Austria, mostly out of case law rather than legislation. In general, courts will initially look to the defendant and claimant to agree a form of payment. Where this is not possible, the court will make a ruling, but agreement between the parties can take place at any time including after a court ruling.

For claims against future loss of income, where the size of the future loss is quantifiable, a monthly payment is usually agreed. Where the loss is not easily quantifiable, a lump sum payment may be agreed. A claimant can also ask the court to make the defendant liable for future losses, as and when they arise, for a period of up to thirty years.

It is possible to go back to the court to seek a review of an order. Reviews are rarely requested in practice because awards are usually indexed. Agreements to settle often include a clause to prevent future changes. Litigation would be required to force the terms of such agreements to be reopened.

### **Belgium**

One-off lump sum payments are the norm for damages in personal injury cases. There is no legal reason why structured settlements could not be awarded if both parties agreed, but the Ministry was unaware of any recent cases where this had happened. Compensation payments are tax-free.

### **Finland**

At present the Finnish legal system states that a person is entitled to compensation for medical costs, loss of income and disability as the result of an injury. The compensation can take the form of a one-off lump sum payment or a structured settlement. In practice, almost all settlements are made as a lump sum payment. Periodical payments are sometimes awarded if a person has permanent loss of income and needs long-term medical care.

The Finnish courts have the power to decide on the method of payment in personal injury cases. The parties do not have to agree to periodical payments for the court to order them. However, in many cases the parties agree on the level and form of compensation without going to court.

The Finnish tort system does not currently allow for reviews of awards. Any payment to cover medical costs and adaptations and special equipment is tax-free. However, a person is taxed on compensation to cover loss of income.

In December 2001, an inter-ministerial working group published a report recommending changes to the compensation system for personal injuries in Finland. In particular it

recommended that there should be clear guidelines on the method of payment to give in different types of personal injury cases.

### **Greece**

The Greek system only allows for damages to be paid in a single lump sum. Lump sums are paid tax-free.

### **Holland**

The court has the power to order payment of a lump sum or periodical payments for future losses. It can also order, in the latter case, that financial security has to be provided. There are several methods to provide for periodical payments including an annuity. These methods can have different fiscal consequences. The choice is at the discretion of the court. The parties do not have to agree to periodical payments for the court to be able to order them. The court can rule, at the request of one of the parties, that the periodical payments can be revised at a later date if the circumstances so require. A request for review has to be brought before the court which decided the original claim for compensation (not necessarily the same judge).

In most cases income tax has to be paid on periodical payments so most claimants prefer a lump sum payment.

### **Portugal**

The Portuguese system allows for damages to be paid in periodical payments. In both civil and criminal processes claimants may be entitled to compensation, which can be either a one-off lump sum or structured payments.

Either party can call for a review where there is a significant change of circumstances. There is no tax liability on income from compensation payments arising from insurance contracts or court decisions. There are exceptions: for example, if the compensation payment is to cover future loss of earnings.

### **Ireland**

Ireland has no system for structured personal injury payments. All settlements and awards are paid in a lump sum. In exceptional circumstances (e.g. compensation for haemophiliacs given infected blood transfusions) structured settlements have been used, but this required one-off legislation.

### **Italy**

The position in Italy is that damages in personal injury cases are routinely paid as a lump sum payment ordered by the judge. Damages can only be paid in periodical payments if the injured party has requested the payments to be made in such a manner.

### **Luxembourg**

The courts have the power to order either a lump sum or periodical payments, although lump sums are favoured. Both lump sums and periodical payments can be reviewed. The claimant receives the settlement tax-free.

## **8.2 Case Estimation**

### **Methodology for determining case estimate amounts**

For Australia the methodology used to determine case reserves for periodical payments is commonly formula based taking into account the earnings and the expected duration of the injury. Statistical case estimation techniques are also being used where more data exist.

In Germany the discounted expected present value is reserved.

In the US individual case estimates are set using a standard mortality table, adjusted by a medical expert.

In France standard mortality tables are generally used for reserving. Impaired annuity tables are allowed, however these are not common due to the lack of data.

Spanish legislation prescribes the mortality tables to be used in reserving, although impaired mortality adjustments may be made on an individual claim basis.

### **What happens to the case estimates on agreement of claims**

In Australia case estimates still remain on the main claims system. Revisions are made if more information is available regarding the nature of the injury.

In the US claims are considered open for the duration of the periodical payment.

In France, once settlement has been agreed, case estimates are generally moved onto a separate claims system, within a ring-fenced life fund. The claim is then considered closed on the main non-life claims system with the last payment being the annuity amount transferred across.

In Sweden the claims are closed on the main claims system and transferred to a separate life fund. Any changes to the case estimates caused by changes in the claimant condition are made on the main claims system as well as the separate life fund.

In Spain the claim is considered open for the duration of the periodical payment.

## **8.3 Reserving methodologies**

In Australia the main reserving methods used for periodical payments include the Payments per Claim Incurred method and the Payments per Active Claim method.

In Sweden, once in the life fund the annuities are valued using general mortality, discounting and inflation assumptions, using life insurance techniques. This is also the French approach.

In Germany reserves are calculated comparable to life insurance reserves with separate impaired life mortality tables on a discounted basis with reference to life company discount rates. The indexation of the payments varies according to the terms of the contract.

## **8.4 Discounting**

Discounting of reserves is mandatory in Australia. The discount rate used makes allowance for the shape of the Government bond yield curve and the timing of the future expected payments.

In Sweden reserves are discounted as appropriate allowing for the indexation and using appropriate rates of interest.

In Germany discounting of reserves is allowed for periodical payments.

In France discounting is allowed in setting the annuity reserves and the discount rate is defined in the French code of practice.

Discounting is not allowed in Spain

## **8.5 Claims Management**

In Australia medical certificates are commonly regularly requested to assess the extent of incapacity.

In Germany Claims managers review each case at least once a year.

In the US, in nearly all cases, structured settlements are not subject to further review.

Insurers in the US can outsource the periodical payments to companies that handle the claims or buy an annuity and can monitor when claimants die or return to work using information available from the Social Security department.

Each year in France, the victim has to provide a doctor's certificate to the insurer before receiving payment. If the victim is not traceable then the insurer does not make the payment but has to set aside the payment in case the victim can eventually be traced.

In Spain an official document, known as a life certificate, has to be presented to the insurer before payment is made.

## **8.6 Reinsurance**

Excess of loss is common in France and recoveries are made at the time of claim settlement based on the capitalised value of any annuity plus the value of the lump sum. Experience adjustment payments may be made by the reinsurer, however this is not common.

In Spain insurers usually receive an initial payment on settlement.

In Germany quota share reinsurance is used by some companies; recoveries are processed over the life of the structured settlement.

## 9 Looking forward

### 9.1 Future Developments

As noted above, it is still very early to estimate the impact of the Courts Act. This makes it difficult to speculate on developments that occur in the future.

The legislation implies that the standard assumption will be for periodical payment orders to vary in line with the RPI. However, courts have the power to make different provisions where these are considered to be more appropriate. In the future, courts may decide that an alternative method of indexation would be more likely to meet the claimant's ongoing need. For example, if a claimant is awarded compensation to cover ongoing care costs, it could be argued that these amounts are likely to increase at a faster rate than retail prices and that the periodical payment order should reflect this.

Our survey results indicate that insurers' operational approaches to periodical payments are likely to change over time. For example, one respondent indicated that it had only settled a single claim with a periodical payment order, and so had simply purchased an annuity. In future, the insurer said it would consider a range of alternative approaches to funding and administration. The insurers' choices will depend on future developments in the annuity and claims outsourcing markets.

At present, we understand that periodical payments are being considered for only the largest claims. Although courts have been directed to consider the scale of annual payments when deciding whether to make an order for periodical payment, no minimum level is specified. Claimant or defendant lawyers may in future argue for smaller awards to be subject to periodical payments if this is thought to be advantageous to their clients.

### 9.2 Positive Opportunities

Much of the analysis of the Courts Act has focussed on possible negative impacts of periodical payments on insurers. However, since actuaries are optimistic by nature, we have noted a number of positive opportunities that periodical payments may offer to insurers.

As noted earlier, the Courts Act allows judges to make periodical payment orders even when the claimant and/or the defendant would rather a lump sum was paid. There is some evidence that claimants prefer to receive a lump sum rather than periodical payments. Where a claimant has a strong preference for a lump sum award, he may be more likely to accept a low out-of-court settlement from an insurer rather than risk receiving a periodical payment if he goes to court.

Retaining the mortality and investment risk could be considered to be a positive opportunity, and make it possible for the cost to an insurer of making periodical payments to be lower than the lump sum cost.

- If the insurer retains the mortality risk, periodical payments would cost less than a lump sum if the claimant dies sooner than expected. The appropriateness of the mortality assumptions used to calculate lump sum awards for claimants was discussed earlier.
- If the insurers retain the investment risk, the expected cost of funding periodical payments could be reduced by investing in assets such as equities. If insurers choose not to match assets and periodical payment liabilities, there would be a benefit to the insurer if the periodical payments increased at a lower rate than the return on the corresponding assets. For example, the periodical payments would generally be linked to the RPI, but assets could be purchased that would be expected to increase at a faster rate.
- Periodical payment cashflows may be preferred by some insurers over a single lump sum

It is not necessary for a court to consider a claimant's likely life expectancy when making an order for periodical payments. This may speed up claim settlement, and reduce the cost of expert medical advice.

Insurers and claimants have tended to be unenthusiastic about variation orders, as finality in settlements has advantages to both parties. However, the ability to request a variation order presents a positive opportunity to insurers where payments can be reduced at a later stage if the claimant's condition improves. If a lump sum payment is made in full and final settlement, the insurer does not stand to gain from any rehabilitation of the claimant. Under periodical payments, it is possible that an insurer could assist the claimant with their rehabilitation and subsequently agree lower compensation payments. The option of rehabilitation may be preferable for some claimants, particularly young people, even if they may later lose some of their compensation. Rehabilitation of victims of accidents is arguably also of benefit to society as a whole.

Lastly we note that by transferring longevity and investment risk from the claimant, periodical payments represent a fairer way to compensate victims than the payment of lump sums. This may raise the public perception of the insurance industry and its important role in society.

## Appendices

### Appendix A – Our survey

<b>Area</b>	<b>Questions</b>
Claims to date	How many claims have been received?  How many claims have been settled? In/Out of court?  Details on the claims (amount, number, class, injury)
Systems	Are payments made in-house/outsourced?  Have claims systems changes been required?
Funding	How are you dealing with the claims? Retaining, purchasing annuities, other?
Reinsurance	Issues from reinsurance negotiations? Have these been solved?  Have there been changes to contract wordings?  Level of involvement of reinsurers in claims settlement?
Cost impact	Impact on non-PP claims?  Level of excess claims inflation predicted/seen?
Reserving	Which classes are you expecting periodical payment claims in?  How are new case reserves set? Bulk adjustment?  What basis is being used to set individual case reserves on agreement of PP?  Have IBNR adjustments been made?

## Appendix B

### Sections 100 and 101 of the Courts Act 2003

<http://www.opsi.gov.uk/acts/acts2003/30039--i.htm#100>

#### 100 Periodical payments

(1) For section 2 of the Damages Act 1996 (c. 48) (periodical payments by consent) substitute-

#### "2 Periodical payments

(1) A court awarding damages for future pecuniary loss in respect of personal injury-

(a) may order that the damages are wholly or partly to take the form of periodical payments, and

(b) shall consider whether to make that order.

(2) A court awarding other damages in respect of personal injury may, if the parties consent, order that the damages are wholly or partly to take the form of periodical payments.

(3) A court may not make an order for periodical payments unless satisfied that the continuity of payment under the order is reasonably secure.

(4) For the purpose of subsection (3) the continuity of payment under an order is reasonably secure if-

(a) it is protected by a guarantee given under section 6 of or the Schedule to this Act,

(b) it is protected by a scheme under section 213 of the Financial Services and Markets Act 2000 (compensation) (whether or not as modified by section 4 of this Act), or

(c) the source of payment is a government or health service body.

(5) An order for periodical payments may include provision-

(a) requiring the party responsible for the payments to use a method (selected or to be selected by him) under which the continuity of payment is reasonably secure by virtue of subsection (4);

(b) about how the payments are to be made, if not by a method under which the continuity of payment is reasonably secure by virtue of subsection (4);

(c) requiring the party responsible for the payments to take specified action to secure continuity of payment, where

continuity is not reasonably secure by virtue of subsection (4);

(d) enabling a party to apply for a variation of provision included under paragraph (a), (b) or (c).

(6) Where a person has a right to receive payments under an order for periodical payments, or where an arrangement is entered into in satisfaction of an order which gives a person a right to receive periodical payments, that person's right under the order or arrangement may not be assigned or charged without the approval of the court which made the order; and-

(a) a court shall not approve an assignment or charge unless satisfied that special circumstances make it necessary, and

(b) a purported assignment or charge, or agreement to assign or charge, is void unless approved by the court.

(7) Where an order is made for periodical payments, an alteration of the method by which the payments are made shall be treated as a breach of the order (whether or not the method was specified under subsection (5)(b)) unless-

(a) the court which made the order declares its satisfaction that the continuity of payment under the new method is reasonably secure,

(b) the new method is protected by a guarantee given under section 6 of or the Schedule to this Act,

(c) the new method is protected by a scheme under section 213 of the Financial Services and Markets Act 2000 (compensation) (whether or not as modified by section 4 of this Act), or

(d) the source of payment under the new method is a government or health service body.

(8) An order for periodical payments shall be treated as providing for the amount of payments to vary by reference to the retail prices index (within the meaning of section 833(2) of the Income and Corporation Taxes Act 1988) at such times, and in such a manner, as may be determined by or in accordance with Civil Procedure Rules.

(9) But an order for periodical payments may include provision-

(a) disapplying subsection (8), or

(b) modifying the effect of subsection (8).

## **2A Periodical payments: supplementary**

(1) Civil Procedure Rules may require a court to take specified matters into account in considering-

- (a) whether to order periodical payments;
- (b) the security of the continuity of payment;
- (c) whether to approve an assignment or charge.

(2) For the purposes of section 2(4)(c) and (7)(d) "government or health service body" means a body designated as a government body or a health service body by order made by the Lord Chancellor.

(3) An order under subsection (2)-

- (a) shall be made by statutory instrument, and
- (b) shall be subject to annulment in pursuance of a resolution of either House of Parliament.

(4) Section 2(6) is without prejudice to a person's power to assign a right to the scheme manager established under section 212 of the Financial Services and Markets Act 2000.

(5) In section 2 "damages" includes an interim payment which a court orders a defendant to make to a claimant.

(6) In the application of this section to Northern Ireland-

- (a) a reference to Civil Procedure Rules shall be taken as a reference to rules of court, and
- (b) a reference to a claimant shall be taken as a reference to a plaintiff.

(7) Section 2 is without prejudice to any power exercisable apart from that section.

## **2B Variation of orders and settlements**

(1) The Lord Chancellor may by order enable a court which has made an order for periodical payments to vary the order in specified circumstances (otherwise than in accordance with section 2(5)(d)).

(2) The Lord Chancellor may by order enable a court in specified circumstances to vary the terms on which a claim or action for damages for personal injury is settled by agreement between the parties if the agreement-

- (a) provides for periodical payments, and
- (b) expressly permits a party to apply to a court for variation in those circumstances.

(3) An order under this section may make provision-

- (a) which operates wholly or partly by reference to a

condition or other term of the court's order or of the agreement;

(b) about the nature of an order which may be made by a court on a variation;

(c) about the matters to be taken into account on considering variation;

(d) of a kind that could be made by Civil Procedure Rules or, in relation to Northern Ireland, rules of court (and which may be expressed to be with or without prejudice to the power to make those rules).

(4) An order under this section may apply (with or without modification) or amend an enactment about provisional or further damages.

(5) An order under this section shall be subject to any order under section 1 of the Courts and Legal Services Act 1990 (allocation between High Court and county courts).

(6) An order under this section-

(a) shall be made by statutory instrument,

(b) may not be made unless the Lord Chancellor has consulted such persons as he thinks appropriate,

(c) may not be made unless a draft has been laid before and approved by resolution of each House of Parliament, and

(d) may include transitional, consequential or incidental provision.

(7) In subsection (4)-

"provisional damages" means damages awarded by virtue of subsection (2)(a) of section 32A of the Supreme Court Act 1981 or section 51 of the County Courts Act 1984 (or, in relation to Northern Ireland, paragraph 10(2)(a) of Schedule 6 to the Administration of Justice Act 1982), and "further damages" means damages awarded by virtue of subsection (2)(b) of either of those sections (or, in relation to Northern Ireland, paragraph 10(2)(b) of Schedule 6 to the Administration of Justice Act 1982)."

(2) In section 329AA of the Income and Corporation Taxes Act 1988 (c. 1) (periodical payments)-

(a) for subsection (1) substitute-

"(1) Periodical payments shall not for the purposes of income tax be regarded as the income of any of the persons mentioned in subsection (2) below (and shall be paid without deduction under section 348(1)(b) or 349(1)).

(1A) In subsection (1) "periodical payments" means periodical payments made pursuant to-

(a) an order of a court in so far as it is made in reliance on section 2 of the Damages Act 1996 (including an order as varied), or

(b) an agreement in so far as it settles a claim or action for damages in respect of personal injury (including an agreement as varied).",

(b) in subsection (3) for "if the agreement or order mentioned in that subsection or a subsequent agreement so provides," substitute "if the order, agreement or undertaking mentioned in subsection (1A), or a varying order, agreement or undertaking, so provides or permits,"

(c) in subsection (6) after "claim or action for" insert "damages in respect of",

(d) for subsection (7) substitute-

"(7) For the purposes of subsection (1A) above-

(a) the reference to an order of a court made in reliance on section 2 of the Damages Act 1996 includes an order of a court outside the United Kingdom which is similar to an order made in reliance on that section,

(b) the reference to an agreement settling a claim or action includes a reference to an agreement to make payments on account of damages that may be awarded in a claim or action, and

(c) the reference to an agreement in so far as it settles a claim or action for damages in respect of personal injury also includes a reference to an undertaking given by the Motor Insurers' Bureau (being the company of that name incorporated on 14th June 1946 under the Companies Act 1929), or an Article 75 insurer under the Bureau's Articles of Association, in relation to a claim or action in respect of personal injury.", and

(e) omit subsection (8).

(3) In section 329AB(1) of that Act (statutory compensation) for "subsection (1)" substitute "subsection (1A)".

(4) In this section-

(a) subsection (1) shall extend only to England and Wales and Northern Ireland, and

(b) the remainder shall extend to the whole of the United Kingdom.

## **101 Periodical payments: security**

(1) For sections 4 and 5 of the Damages Act 1996 (c. 48) (enhanced protection for structured settlement annuitant) substitute-

**"4 Enhanced protection for periodical payments**

(1) Subsection (2) applies where-

- (a) a person has a right to receive periodical payments, and
- (b) his right is protected by a scheme under section 213 of the Financial Services and Markets Act 2000 (compensation), but only as to part of the payments.

(2) The protection provided by the scheme shall extend by virtue of this section to the whole of the payments.

(3) Subsection (4) applies where-

- (a) one person ("the claimant") has a right to receive periodical payments from another person ("the defendant"),
- (b) a third person ("the insurer") is required by or in pursuance of an arrangement entered into with the defendant (whether or not together with other persons and whether before or after the creation of the claimant's right) to make payments in satisfaction of the claimant's right or for the purpose of enabling it to be satisfied, and
- (c) the claimant's right to receive the payments would be wholly or partly protected by a scheme under section 213 of the Financial Services and Markets Act 2000 if it arose from an arrangement of the same kind as that mentioned in paragraph (b) but made between the claimant and the insurer.

(4) For the purposes of the scheme under section 213 of that Act-

- (a) the claimant shall be treated as having a right to receive the payments from the insurer under an arrangement of the same kind as that mentioned in subsection (3)(b),
- (b) the protection under the scheme in respect of those payments shall extend by virtue of this section to the whole of the payments, and
- (c) no person other than the claimant shall be entitled to protection under the scheme in respect of the payments.

(5) In this section "periodical payments" means periodical payments made pursuant to-

- (a) an order of a court in so far as it is made in reliance on section 2 above (including an order as varied), or
- (b) an agreement in so far as it settles a claim or action for damages in respect of personal injury (including an

agreement as varied).

(6) In subsection (5)(b) the reference to an agreement in so far as it settles a claim or action for damages in respect of personal injury includes a reference to an undertaking given by the Motor Insurers' Bureau (being the company of that name incorporated on 14th June 1946 under the Companies Act 1929), or an Article 75 insurer under the Bureau's Articles of Association, in relation to a claim or action in respect of personal injury."

(2) In section 6(1) of the Damages Act 1996 (c. 48) (guarantee for public sector settlement) for the words "on terms corresponding to those of a structured settlement as defined in section 5 above except that the person to whom the payments are to be made is not to receive them as mentioned in subsection (1)(b) of that section" substitute "on terms whereby the damages are to consist wholly or partly of periodical payments".

(3) In paragraph 1(a) of the Schedule to that Act (guarantee by Northern Ireland Department for public sector settlement) for the words "on terms corresponding to those of a structured settlement as defined in section 5 of this Act except that the person to whom the payments are to be made is not to receive them as mentioned in subsection (1)(b) of that section" substitute "on terms whereby the damages are to consist wholly or partly of periodical payments".

(4) Where an individual who has a right to receive periodical payments becomes bankrupt-

(a) the payments shall be treated for the purposes of the bankruptcy as income of the bankrupt (but without prejudice to section 329AA of the Income and Corporation Taxes Act 1988 (c. 1)),

(b) neither the right to receive periodical payments, nor any property or arrangement designed to protect continuity of the periodical payments, shall form part of the bankrupt's estate for the purposes of the Insolvency Act 1986 (c. 45) or the Insolvency (Northern Ireland) Order 1989 (S.I. 1989&sol;2405 (N.I. 19)),

(c) an income payments order may not be made in respect of any part of the periodical payments identified (in the order or agreement under which the payments are made) as relating wholly to expenditure likely to be incurred by or for the individual as a result of the personal injury concerned,

(d) nothing in section 2 of the Damages Act 1996 (c. 48) shall prevent a court from making an income payments order (subject to paragraph (c)), and

(e) nothing in section 2 of that Act shall prevent entry into an income payments agreement.

(5) In subsection (4)-

"bankrupt" has the meaning given by section 381 of the Insolvency

Act 1986 or Article 9 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989&sol;2405 (N.I. 19)),

"income payments agreement" means an agreement under section 310A of that Act or equivalent legislation for Northern Ireland,

"income payments order" means an order under section 310 of that Act or equivalent legislation for Northern Ireland, and

"periodical payments" means periodical payments awarded or agreed, or in so far as awarded or agreed, as damages for future pecuniary loss by-

(a) an order of a court made in reliance on section 2 of the Damages Act 1996 (including an order as varied), or

(b) an agreement settling a claim or action for damages in respect of personal injury (including an agreement as varied).

(6) In this section-

(a) subsections (1) to (3) shall extend to the whole of the United Kingdom, and

(b) subsections (4) and (5) shall extend only to England and Wales and Northern Ireland.

## Appendix C

### Explanatory notes to the Courts Act 2003 – Damages section

<http://www.opsi.gov.uk/acts/en2003/2003en39.htm>

#### Damages

224. These sections aim to promote the widespread use of periodical payments as the means of paying compensation for future financial loss in personal injury cases. In principle, periodical payments made as the needs arise provide a more appropriate means of compensating claimants than lump sums. The sections amend provisions in the Damages Act 1996 relating to periodical payments and structured settlements (which are periodical payments funded by an annuity). At present, the court can only order that an award of damages for personal injury be made by way of periodical payments where both parties consent, and otherwise will order payment by way of a lump sum.

225. The Act enables courts in England, Wales and Northern Ireland to order periodical payments for future loss and care costs without the consent of the parties. It also gives the Lord Chancellor a power to enable awards or agreements for periodical payments to be varied under specified circumstances, and prevents the assignment of the right to receive payments unless the court is satisfied that there are special circumstances which make this necessary.

226. Provision is made to extend the statutory protection given to structured settlements under the 1996 Act, and ensure that the continuity of periodical payments is fully protected where the payments are self-funded by an insurer, a public sector body protected by Ministerial guarantee, or a specified Government or health service body, or where payments are funded by an annuity. These provisions will apply to the whole of the United Kingdom.

227. These sections implement proposals set out in Damages for future loss: Giving the courts the power to order periodical payments in personal injury cases, a Consultation Paper published by the Lord Chancellor's Department on 13 March 2002. The post-consultation report was published on 7 November 2002. These documents have been placed in the Libraries of both Houses.

## Appendix D

### The Civil Procedure (Amendment No. 3) Rules 2004 including PERIODICAL PAYMENTS UNDER THE DAMAGES ACT 1996

<http://www.opsi.gov.uk/si/si2004/20043129.htm>

2004 No. 3129 (L. 24 )

#### SUPREME COURT OF ENGLAND AND WALES

#### COUNTY COURTS, ENGLAND AND WALES

#### The Civil Procedure (Amendment No. 3) Rules 2004

<i>Made</i>	<i>24th November 2004</i>
<i>Laid before Parliament</i>	<i>30th November 2004</i>
<i>Coming into force in accordance with Rule 1</i>	

The Civil Procedure Rule Committee, having power under section 2 of the Civil Procedure Act 1997<sup>[1]</sup> to make rules of court under section 1 of that Act, after consulting in accordance with section 2(6)(a) of that Act, make the following Rules -

#### **Citation, commencement and interpretation**

1. These Rules may be cited as the Civil Procedure (Amendment No.3) Rules 2004 and shall come into force on the date of entry into force of section 100 of the Courts Act 2003<sup>[2]</sup>.

2. In these Rules a reference to a Part or rule by number alone means the Part or rule so numbered in the Civil Procedure Rules 1998<sup>[3]</sup>.

#### **Amendment to the Civil Procedure Rules 1998**

3. In rule 36.3(1), after "rules", insert "36.2A(2)",.

4. After rule 36.2, insert -

#### **" Personal injury claims for future pecuniary loss**

**36.2A** - (1) This rule applies to a claim for damages for personal injury which is or includes a claim for future pecuniary loss.

(2) An offer to settle such a claim will not have the consequences set out in this Part unless it is made by way of a Part 36 offer under this rule, and where such an offer is or includes an offer to pay the whole or part of any damages in the form of a lump sum, it will not have the consequences set out in this Part unless a Part 36 payment of the amount of the lump sum offer is also made.

(3) Where both a Part 36 offer and a Part 36 payment are made under this rule -

(a) the offer must include details of the payment, and

(b) rules 36.11(1) and (2) and 36.13(1) and (2) apply as if there were only a Part 36 offer.

(4) A Part 36 offer to which this rule applies may contain an offer to pay, or an offer to accept -

(a) the whole or part of the damages for future pecuniary loss in the form of -

(i) either a lump sum or periodical payments, or

(ii) both a lump sum and periodical payments,

(b) the whole or part of any other damages in the form of a lump sum.

(5) A Part 36 offer to which this rule applies -

(a) must state the amount of any offer to pay the whole or part of any damages in the form of a lump sum;

(b) may state what part of the offer relates to damages for future pecuniary loss to be accepted in the form of a lump sum;

(c) may state, where part of the offer relates to other damages to be accepted in the form of a lump sum, what amounts are attributable to those other damages;

(d) must state what part of the offer relates to damages for future pecuniary loss to be paid or accepted in the form of periodical payments and must specify -

(i) the amount and duration of the periodical payments,

(ii) the amount of any payments for substantial capital purchases and when they are to be made, and

(iii) that each amount is to vary by reference to the retail prices index (or to some other named index, or that it is not to vary by reference to any index); and

(e) must state either that any damages which take the form of periodical payments will be funded in a way which ensures that the continuity of payment is reasonably secure in accordance with section 2(4) of the Damages Act 1996 or how such damages are to be paid and how the continuity of their payment is to be secured.

(6) Where a Part 36 payment includes a lump sum for damages for future pecuniary loss, the Part 36 payment notice may state the amount of that lump sum.

(7) Where the defendant makes a Part 36 offer to which this rule applies and which offers to pay damages in the form of both a lump sum and periodical payments, the claimant may only give notice of acceptance of the offer as a whole."

**5. In rule 36.4 -**

(a) in paragraphs (2)(a), (3)(b) and (4) after "Part 36 payment" insert "or Part 36 offer made under rule 36.2A";

(b) in paragraph (3) after "Part 36 payment notice" insert "or Part 36 offer made under rule 36.2A";

(c) in paragraph (3) after "the Part 36 offer", in both places, insert "made under this rule."

**6. In rule 36.10 -**

(a) in paragraph (3) for "If the offeror" substitute "Subject to paragraph (3A), if the offeror";

(b) after paragraph (3) insert -

" (3A) In a claim to which rule 36.2A applies, if the offeror is a defendant who wishes to offer to pay the whole or part of any damages in the form of a lump sum -

(a) he must make a Part 36 payment within 14 days of service of the claim form; and

(b) the amount of the payment must be not less than the lump sum offered before proceedings began.";

(c) in paragraph (4)(b) after "paragraph (3)" insert "or (3A)".

**7. In rule 36.20, in paragraph (1)(a) delete "or" and in paragraph (1)(b) after "offer" insert "or" -**

" (c) in a claim to which rule 36.2A applies, fails to obtain a judgment which is more advantageous than the Part 36 offer made under that rule."

**8. In rule 36.21, in paragraph (1), after "Part 36 offer" insert "(including a Part 36 offer made under rule 36.2A)".**

**9. In rule 36.23 -**

(a) in paragraph (4), for "rule 36.20" substitute "rule 36.20(1)(a)" and

(b) after paragraph (4), insert -

" (4A) For the purposes of rule 36.20(1)(c), where the court is determining whether the claimant has failed to obtain a judgment which is more advantageous than the Part 36 offer made under rule 36.2A, the amount of any lump sum paid into court which it takes into account is to be the amount of the gross sum specified in the Part 36 payment notice."

10. For the heading of Part 41, substitute "**DAMAGES**".

11. In Part 41 -

(a) for the table of contents, substitute the table of contents and section heading as set out in Part I of Schedule 1 to these Rules;

(b) in rule 41.1 -

(i) in paragraph (1), for "This Part" substitute "This Section of this Part";

(ii) in paragraph (2), for "Part" substitute "Section"; and

(c) after rule 41.3, insert Section II as set out in Part II of Schedule 1 to these Rules.

*Phillips of Worth Matravers, M.R.*

*John Dyson, L.J.*

*Rupert Jackson, J.*

*Terence Etherton, J.*

*Stephen Oliver-Jones*

*Steven Whitaker*

*Carlos Dabezies*

*Nicholas Burkill*

*Richard Walford*

*David di Mambro*

*Juliet Herzog*

*Andrew Parker*

*Philip Rainey*

*Peter Candon*

I allow these Rules

*Falconer of Thoroton, C.*

Dated 24th November 2004

## SCHEDULE 1

Rule 11

### PART I

#### CONTENTS OF THIS PART

#### **I - PROCEEDINGS TO WHICH SECTION 32A OF THE SUPREME COURT ACT 1981 OR SECTION 51 OF THE COUNTY COURTS ACT**

**1984 APPLIES**

Application and definitions	Rule 41.1
Order for an award of provisional damages	Rule 41.2
Application for further damages	Rule 41.3

**II - PERIODICAL PAYMENTS UNDER THE DAMAGES ACT 1996**

Scope and interpretation	Rule 41.4
Statement of case	Rule 41.5
Court's indication to parties	Rule 41.6
Factors to be taken into account	Rule 41.7
The award	Rule 41.8
Continuity of payment	Rule 41.9
Assignment or charge	Rule 41.10

I - PROCEEDINGS TO WHICH SECTION 32A OF THE SUPREME COURT ACT 1981 OR SECTION 51 OF THE COUNTY COURTS ACT 1984 APPLIES"

PART II

II - PERIODICAL PAYMENTS UNDER THE DAMAGES ACT 1996

**Scope and interpretation**

**41.4** - (1) This Section of this Part contains rules about the exercise of the court's powers under section 2(1) of the 1996 Act to order that all or part of an award of damages in respect of personal injury is to take the form of periodical payments.

(2) In this Section -

(a) "the 1996 Act" means the Damages Act 1996[4];

(b) "damages" means damages for future pecuniary loss;  
and

(c) "periodical payments" means periodical payments under section 2(1) of the 1996 Act[5].

**Statement of case**

**41.5** - (1) In a claim for damages for personal injury, each party in its statement of case may state whether it considers periodical payments or a lump sum is the more appropriate form for all or part of an award of damages and where such statement is given must provide relevant particulars of the circumstances which are relied on.

(2) Where a statement under paragraph (1) is not given, the court may order a party to make such a statement.

(3) Where the court considers that a statement of case contains insufficient particulars under paragraph (1), the court may order a party to provide such further particulars as it considers appropriate.

### **Court's indication to parties**

**41.6.** The court shall consider and indicate to the parties as soon as practicable whether periodical payments or a lump sum is likely to be the more appropriate form for all or part of an award of damages.

### **Factors to be taken into account**

**41.7.** When considering -

(a) its indication as to whether periodical payments or a lump sum is likely to be the more appropriate form for all or part of an award of damages under rule 41.6; or

(b) whether to make an order under section 2(1)(a) of the 1996 Act,

the court shall have regard to all the circumstances of the case and in particular the form of award which best meets the claimant's needs, having regard to the factors set out in the practice direction.

### **The award**

**41.8.** - (1) Where the court awards damages in the form of periodical payments, the order must specify -

(a) the annual amount awarded, how each payment is to be made during the year and at what intervals;

(b) the amount awarded for future -

(i) loss of earnings and other income; and

(ii) care and medical costs and other recurring or capital costs;

(c) that the claimant's annual future pecuniary losses, as assessed by the court, are to be paid for the duration of the claimant's life, or such other period as the court orders; and

(d) that the amount of the payments shall vary annually by reference to the retail prices index, unless the court orders otherwise under section 2(9) of the 1996 Act.

(2) Where the court orders that any part of the award shall continue after the claimant's death, for the benefit of the

claimant's dependants, the order must also specify the relevant amount and duration of the payments and how each payment is to be made during the year and at what intervals.

(3) Where an amount awarded under paragraph (1)(b) is to increase or decrease on a certain date, the order must also specify -

(a) the date on which the increase or decrease will take effect; and

(b) the amount of the increase or decrease at current value.

(4) Where damages for substantial capital purchases are awarded under paragraph (1)(b)(ii), the order must also specify -

(a) the amount of the payments at current value;

(b) when the payments are to be made; and

(c) that the amount of the payments shall be adjusted by reference to the retail prices index, unless the court orders otherwise under section 2(9) of the 1996 Act.

### **Continuity of payment**

**41.9.** - (1) An order for periodical payments shall specify that the payments must be funded in accordance with section 2(4) of the 1996 Act, unless the court orders an alternative method of funding.

(2) Before ordering an alternative method of funding, the court must be satisfied that -

(a) the continuity of payment under the order is reasonably secure; and

(b) the criteria set out in the practice direction are met.

(3) An order under paragraph (2) must specify the alternative method of funding.

### **Assignment or charge**

**41.10.** Where the court under section 2(6)(a) of the 1996 Act is satisfied that special circumstances make an assignment or charge of periodical payments necessary, it shall, in deciding whether or not to approve the assignment or charge, also have regard to the factors set out in the practice direction."

## EXPLANATORY NOTE

*(This note is not part of the Rules)*

These Rules insert into the Civil Procedure Rules 1998 a new Section II of Part 41, which makes provision about the exercise of the court's powers under section 2(1) of the Damages Act 1996 (as substituted by section 100 of the Courts Act 2003) to order that all or part of an award of damages in respect of personal injury is to take the form of periodical payments. Section II of Part 41 will come into force at the same time as section 100 of the Courts Act 2003.

Amendments are also made to Part 36 to ensure that the scheme for offers to settle and payments into court can work in cases in which periodical payments may be awarded.

---

*Notes:*

[1] 1997 c. 12

[2] 2000 c.39

[3] S.I. 1998/3132. There are relevant amendments in S.I. 1999/1008, S.I. 2000/2092 and S.I. 2002/3219

[4] 1996 c. 48

[5] Section 2 is substituted by section 100 of the Courts Act 2003 (c. 39).

---

ISBN 0 11050591 3

## Appendix E

### The Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 –

#### Schedule 1 - Form and Content of Accounts of Insurance Companies and Groups

[http://www.opsi.gov.uk/si/si1993/Uksi\\_19933246\\_en\\_1.htm#tcon](http://www.opsi.gov.uk/si/si1993/Uksi_19933246_en_1.htm#tcon)

##### *Provisions for claims outstanding General business*

**47.**—(1) A provision shall in principle be computed separately for each claim on the basis of the costs still expected to arise, save that statistical methods may be used if they result in an adequate provision having regard to the nature of the risks.

(2) This provision shall also allow for claims incurred but not reported by the balance sheet date, the amount of the allowance being determined having regard to past experience as to the number and magnitude of claims reported after previous balance sheet dates.

(3) All claims settlement costs (whether direct or indirect) shall be included in the calculation of the provision.

(4) Recoverable amounts arising out of subrogation or salvage shall be estimated on a prudent basis and either deducted from the provision for claims outstanding (in which case if the amounts are material they shall be shown in the notes to the accounts) or shown as assets.

(5) In sub-paragraph (4) above, "subrogation" means the acquisition of the rights of policy holders with respect to third parties, and "salvage" means the acquisition of the legal ownership of insured property.

(6) Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose shall be calculated by recognised actuarial methods, and paragraph 48 below shall not apply to such calculations.

(7) Implicit discounting or deductions, whether resulting from the placing of a current value on a provision for an outstanding claim which is expected to be settled later at a higher figure or otherwise effected, is prohibited.

**48.**—(1) Explicit discounting or deductions to take account of investment income is permitted, subject to the following conditions:

(a) the expected average interval between the date for the settlement of claims being discounted and the accounting date shall be at least four years;

(b) the discounting or deductions shall be effected on a recognised prudential basis;

(c) when calculating the total cost of settling claims, the company shall take account of all factors that could cause increases in that cost;

(d) the company shall have adequate data at its disposal to construct a reliable model of the rate of claims settlements;

(e) the rate of interest used for the calculation of present values shall not exceed a rate prudently estimated to be earned by assets of the company which are appropriate in magnitude and nature to cover the provisions for claims being discounted during the period necessary for the payment of such claims, and shall not exceed either —

(i) a rate justified by the performance of such assets over the preceding five years, or

(ii) a rate justified by the performance of such assets during the year preceding the balance sheet date.

(2) When discounting or effecting deductions, the company shall, in the notes to the accounts, disclose —

(a) the total amount of provisions before discounting or deductions,

(b) the categories of claims which are discounted or from which deductions have been made,

(c) for each category of claims, the methods used, in particular the rates used for the estimates referred to in sub-paragraph (1)(d) and (e), and the criteria adopted for estimating the period that will elapse before the claims are settled.

## **Appendix F**

### **DCA – Guidance on Periodical Payments**

<http://www.dca.gov.uk/pubs/pps-guidance-final.pdf>



## Guidance on Periodical Payments

### Index

Introduction

Policy Background

Power to Order Periodical Payments

- Are periodical payments appropriate?
- Calculating periodical payments
- Making an order for periodical payments
- Indexation

Security of Payments

What methods of funding does section 2(4) cover?

What isn't covered by section 2(4)?

Security terms of an order for periodical payments

Security terms of settlements

Changes to methods of funding

Funding Periodical Payments

- Types of annuity
- Availability of ILGS after 2035

Tax treatment of periodical payments

Assignment/Charge of right to receive payments

Offers to settle (Part 36 of the Civil Procedure Rules)

- Introduction
- The Rule amendments

Variable Orders and Agreements

- Contents of variable order
- Variable orders and liability
- Case file
- Contents of variable agreement
- Applications for permission
- Orders for variation

Annex A: Statutory Instruments and Consequential Amendments to other Practice Directions

Annex B: Periodical Payments and Means Tested Benefits; Periodical Payments and Insolvency

Annex C: Protection for Payments under the Financial Services Compensation Scheme

## **Introduction**

1. This guidance has been prepared by the Department for Constitutional Affairs and provides factual information on the substance of these provisions and on the intentions of the Government in introducing them, for the assistance of members of the judiciary, practitioners, insurers, and others involved in personal injury cases. To the best of our knowledge and belief the information is correct as at 1 April 2005, but this guidance should not be regarded as an authoritative interpretation of the law and regulations described.
2. Section 2 of the Damages Act 1996 gave courts in the United Kingdom the power to order that damages for future pecuniary loss in respect of personal injury are to be paid wholly or partly in the form of periodical payments rather than a lump sum, provided that the parties consent. The power did not extend to making such an order should the parties not both consent, or to varying the order subsequently.
3. Section 100 of the Courts Act 2003 amends the 1996 Act to extend the power in respect of England, Wales and Northern Ireland. It replaces section 2 of the 1996 Act with a new section 2 (enabling the court to order that damages for future pecuniary loss in respect of personal injury should take the form wholly or partly of periodical payments); a new section 2A (enabling provision to be made by Civil Procedure Rules, or in Northern Ireland by rules of court, requiring the court to take specified matters into account when considering the exercise of that power); and a new section 2B, which provides that the Lord Chancellor may by Order enable a court to vary an order or settlement providing for periodical payments in specified circumstances.
4. Section 101 of the 2003 Act replaces sections 4 and 5 of the 1996 Act on "structured settlements" with a new section 4 making provision for enhanced protection for "periodical payments". This change in terminology reflects a fundamental difference. Periodical payments will be just that, and will not need to be calculated as a lump sum which is then "structured" to purchase an annuity.

## **Policy background**

5. This section provides background on the Government's policy intentions in introducing the provisions on periodical payments and reflects views expressed during their development and passage of the proposals through Parliament. This is for the information of those using the new legislation. The interpretation of the legislation, and the interpretation and application of the rules and practice direction, in individual cases is of course a matter for the courts.
6. The Government's policy intentions in introducing the provisions in the Courts Act 2003 were based on the belief that the existing system of compensation for future losses by way of lump sums is unsatisfactory, and that periodical payments are usually a much better and fairer way of

compensating those facing long term future loss and care needs. As the Law Commission recognised in its 1994 report "Structured Settlements and Interim and Provisional Damages", the principles of tort law do not create a right to compensation in the form of a lump sum to compensate for future loss in advance of that loss being incurred.<sup>1</sup> Ministers adopted this analysis during passage of the Courts Act, indicating that the claimant's needs should be paramount, and not the claimant's wishes.

7. Periodical payments generally have a number of potential advantages over lump sums:
  - The lump sum system is based on predictions about the future life expectancy of a claimant which are inevitably uncertain and almost always lead to over-compensation or under-compensation. In contrast, periodical payments ensure that people receive appropriate compensation for as long as it is needed.
  - Periodical payments should also avoid the need for argument about life expectancy during the litigation. This is often unpleasant and stressful for the claimant. It will not be necessary to assess life expectancy to decide the value of periodical payments that will meet the claimant's future needs (an actuarial judgment on life expectancy will still be relevant to the issue of how payments are to be funded by the defendant; but this should not form part of the litigation or concern the claimant).
  - There will be greater security for claimants, who will be able to plan for the future without the anxiety of the award running out if they live longer than expected.
  - Claimants will not have to bear the risks associated with investing and managing a lump sum award. These risks will fall on defendants, who are generally far better able to bear them.
  - This should remove the need for claimants to obtain detailed financial advice on the investment and management of the award, but equally the system will provide greater flexibility for defendants to choose how to fund the payments, provided the needs of the claimant as ordered or agreed are met.
8. An important principle underlying the introduction of the power to order periodical payments was that it should lead to a fundamental change in the way in which these payments are calculated. Instead of the traditional "top-down" approach used for structured settlements, requiring uncertain assumptions about life expectancy and investment, it is intended that where a periodical payments order is made or agreed, a "bottom-up"

---

(1994) Law Com No 224, p 38, para 3.39

approach will be adopted, which focuses instead on calculating the annual future needs of the claimant (a fuller explanation of the two approaches is at paras 21 to 25 below). Moving from a "top-down" to a "bottom-up" approach means that the claimant should no longer need financial advice on how to "structure" the payments or on the best priced annuity available to meet his or her needs. The "bottom-up" approach places the onus on the defendant to decide how to meet the terms of the court order or settlement.

9. Section 2 of the Damages Act, as amended by section 100 of the Courts Act, requires the court to consider whether periodical payments are suitable in all cases involving future pecuniary loss. Ministers considered that the size of the award should not be a determining factor in deciding whether periodical payments are suitable, and that it would not be appropriate to prescribe a fixed level of award below which periodical payments would not be appropriate. Their view was that periodical payments were in principle suitable to all future loss of a significant amount or duration, provided the payments were not so small as to make their use disproportionate.
10. Two issues which were the subject of particular debate during passage of the Courts Act were the indexation of periodical payments and the scope for variation of periodical payments orders and agreements. On indexation, Ministers made clear that the provisions on periodical payments focus on how payments of personal injury compensation are made, not on how such claims are to be quantified. The provisions in the Act on indexation of periodical payments were therefore merely intended to reflect the current position, where lump sums are linked to RPI in the great majority of cases. But it would remain open to the court to adopt a different index (or none) in a particular case if there were particular exceptional circumstances which justified its doing so.<sup>2</sup>
11. The issues surrounding the variation of periodical payments were extensively debated in Parliament during passage of the Courts Act. In those debates, the Government made clear its belief that the ability to vary payments in certain limited circumstances has a part to play in the scheme for periodical payments. Ministers indicated that the scope for variation would be tightly controlled, and that, while they hoped that the use of periodical payments in appropriate personal injury cases would become the norm, they expected that the use of variable orders would be very limited, and that in the majority of cases a non-variable award was likely to be more appropriate. In addition, Ministers indicated their view that, if the increase or decrease in pecuniary loss which arose was only minimal, it was unlikely that an order for variation would be appropriate.
12. However, there can sometimes be real difficulties in assessing the likelihood of a claimant developing a particular medical condition or overcoming a particular medical disability at the time that the periodical

---

<sup>1</sup> *Hansard* (HL) 19 May 2003, vol 648, col 536 and 537

payments order is made. This can make it extremely difficult to assess the claimant's likely future need for care at all accurately at that time. In these cases the Government's view was that a variable order could provide the best solution (see detailed guidance on variation below).

### **The power to order periodical payments**

13. New Section 2(1) of the 1996 Act provides that a court awarding damages for future pecuniary loss in respect of personal injury (a) may order that the damages are wholly or partly to take the form of periodical payments and (b) shall consider whether to make that order.
14. The effect of this provision is that the court must consider in every case involving future pecuniary loss (for example, the loss of future earnings and the cost of future care) whether periodical payments are a suitable means to pay all or part of the award, and is able to make an order to that effect without the consent of the parties.
15. This new power also applies to claims or actions under the Fatal Accidents Act 1976 and the Law Reform (Miscellaneous Provisions) Act 1934 (in respect of claims for the benefit of the deceased's estate) as provided for under section 7 of the 1996 Act. However, it does not apply to other damages for personal injury, for example past loss or non-pecuniary loss such as pain and suffering. Section 2(2) provides that periodical payments may, as now, be ordered in these circumstances if both parties consent. It also does not apply to claims for damage to property.
16. The power to order periodical payments without the consent of the parties applies in all cases which have not been finalised before 1 April 2005. Provisions on the making of variable orders for periodical payments will apply only to proceedings which are issued on or after the date of implementation.

### **Are periodical payments appropriate?**

17. The primary consideration established by the new section 2 of the Damages Act in deciding whether periodical payments are appropriate is whether the continuity of the payments is reasonably secure (see section on security below). Part 41 of the Civil Procedure Rules (as amended by the Civil Procedure (Amendment No 3) Rules) sets out the following procedures in relation to the court's consideration under section 2(1)(b).
18. Rule 41.6 requires the court to consider and indicate to the parties as soon as practicable whether periodical payments or a lump sum is likely to be the more appropriate form for all or part of the damages. To assist the court in reaching this decision, Rule 41.5 enables the parties to state a view on this issue in their statements of case and, where they do, requires them to provide relevant particulars of the circumstances which are relied on. Where a party does not state a view in the statement of case, Rule 41.5 allows the court to order them to do so. The court is also able to order

that further particulars be provided if the details in the statement of case are insufficient. These provisions should also assist the parties in negotiations.

19. The Rules allow a wide discretion to take into account all the circumstances of an individual case in deciding whether periodical payments are appropriate. Rule 41.7 requires the court, in reaching a decision on whether periodical payments are likely to be suitable or on whether to make an order, to have regard to all the circumstances of the case and, in particular, the form of award which best meets the claimant's needs.
20. Practice Direction 41B provides that the factors that the court shall have regard to in reaching either of these decisions include:
  - the scale of the annual payments taking into account any deduction for contributory negligence
  - the form of the award preferred by the claimant, including the reasons for the claimant's preference and the nature of any financial advice received by the claimant when considering the form of the award
  - the form of award preferred by the defendant, including the reasons for the defendant's preference

#### Calculating periodical payments

21. The Rules and Practice Directions supporting the provisions in the Courts Act have been formulated to reflect the use of the "bottom-up" approach to calculating payments. It has previously been usual for structured settlements to be arrived at by using the "top-down" approach.
22. Under the "bottom-up" approach, the various heads of damages (loss of earnings/costs of care etc) are considered to estimate the annual needs of the claimant. The order for periodical payments then simply provides for the claimant to be paid the appropriate amounts for the duration of his or her need (usually life), escalating in line with the RPI unless the court orders otherwise. This means that there is no need for speculative estimates or extended disputes about life expectancy, as payments will be based on the claimant's annual needs and will be payable for as long as necessary.
23. The "bottom-up" method also allows for a flexible approach to funding to be adopted, under which the defendant or his or her insurer can fund the annual payments in whatever way they prefer, providing the payments reflect the terms of the order and are reasonably secure as defined by the Courts Act (see section on security below).

24. By contrast, the "top-down" approach reflects the method of calculating lump sums and preserves many of the disadvantages attached to those payments. Using this method, the various heads of damages are considered to estimate the annual needs of the claimant (the multiplicands). Using the Ogden Tables, appropriate multipliers are determined for these multiplicands. Within their calculation, the multipliers make implicit allowance for inflation, life expectancy and a discount rate.
25. The defendant insurer then purchases an annuity for the claimant, using all or part of this lump sum figure as the premium. The price of the annuity will reflect the state of the annuity market at the time, and is unlikely to reflect the assumptions used for the Ogden Tables, so the resulting payments are unlikely to match the original assessment of annual needs.

#### Making an order for periodical payments

26. Rule 41.8(1) prescribes a range of issues which must be addressed in any order for periodical payments. These are intended to ensure that the annual amount, duration and timing of the payments are specified; that the award for future loss is broken down into losses (such as loss of earnings) and recurring or capital costs (such as care and medical costs); and that provision is included for the payments to vary annually, usually by reference to the Retail Prices Index unless the court orders otherwise under section 2(9) of the Act (see paragraph 30 below). The requirement to indicate separately losses and costs is intended to facilitate the relationship of periodical payments with social security and insolvency provisions (see Annex B below).
27. If the parties wish the terms of a settlement to be embodied in a consent order, it will be necessary for the order to satisfy the requirements of Rule 41.8 and Rule 41.9. This will also be necessary where the court approves a settlement or compromise involving periodical payments by or on behalf of a child or patient (see Annex A below).
28. In addition, Rules 41.8(3) and (4) require further details to be included in the order where the amount awarded is to increase or decrease on a certain date, or where damages for substantial capital purchases are awarded. Paragraph 2.2 of the Practice Direction gives examples of circumstances which might lead the court to order an increase or decrease under Rule 41.8(3). These include where the court determines that the claimant's condition will change leading to an increase or reduction in his or her need to incur care, medical or other recurring or capital costs; or where gratuitous carers will no longer continue to provide care.
29. Rule 41.8(2) deals with circumstances where the court considers that any part of the award should continue after the claimant's death for the benefit of his or her dependants, and requires the order to specify the relevant amount and duration of the payments and how each payment is to be made during the year and at what intervals. In relation to duration, for

example, the court might order that damages of £x for care costs should last for the lifetime of the claimant, but that all or part of the damages for loss of earnings (£y) should last beyond the death of the claimant until his child has reached the age of 18. In deciding how much £y will be, the court will wish to take into account that periodical payments paid other than to the claimant are no longer tax exempt following the claimant's death (see section on tax treatment below). Paragraph 2.1 of the Practice Direction explains that this applies in situations where a dependant would have had a claim under section 1 of the Fatal Accidents Act 1976 if the claimant had died at the time of the accident (for example, the court may consider that compensation for loss of earnings should cover the duration of the dependency).

#### Indexation of periodical payments

30. Section 2(8) of the amended 1996 Act provides that periodical payments orders will be treated as providing for the amount of payments to vary by reference to the Retail Prices Index (RPI). However subsection (9) preserves the court's power to make different provision where circumstances make it appropriate. Rule 41.8 requires the index to be specified in the order.

#### **Security of payments**

31. It is clearly very important that any periodical payments ordered by the court can be paid for the period specified in the order. Section 2(3) of the 1996 Act therefore requires a court making an order for periodical payments to be satisfied that the continuity of payments under the order is reasonably secure.

32. In order that the court does not have to give specific consideration to the future security of periodical payments in every individual case, section 2(4) provides that the continuity of payment can automatically be considered to be reasonably secure where:

- (a) it is protected by a Ministerial guarantee under section 6 of the 1996 Act
- (b) it protected by a scheme under section 213 of the Financial Services and Markets Act 2000, or
- (c) the source of the payments is a government or health service body

#### What methods of funding does 2(4) cover?

33. Section 2(4)(a) covers "self-funded" payments made directly by public sector bodies where a Minister has specifically guaranteed those payments under section 6 of the 1996 Act. At present no such guarantees have been given, but it is possible for this to be done in a particular case or generally (for example in respect of non-departmental public bodies).

34. Section 2(4) (b) covers payments which attract protection under the Financial Services Compensation Scheme (FSCS), i.e. payments made by authorised insurers. This covers both -
- (a) "self-funded" payments that are to be made directly by a defendant's liability insurer (with the exception of aircraft and shipping insurance, see paragraph 37 below) to the claimant, and
  - (b) payments made by a life insurer under an annuity contract. The annuity may of course have been bought by the defendant, the defendant's insurer, a defence organisation etc. The annuity could either be bought in the name of the claimant or be held by the defendant with some or all of the income directed to the claimant as beneficial owner. This allows defendants the flexibility to adopt the funding approach that best suits them while ensuring that the claimant's needs are met.

A detailed explanation of how these payments are protected under the Financial Services Compensation Scheme, including how the enhanced protection under section 4 of the 1996 Act works, is at Annex C.

35. Section 2(4) (c) covers payments made by government or health service bodies. The Damages (Government and Health Service Bodies) Order 2005 lists the bodies which are designated as government and health service bodies for this purpose. Designation under the Order removes the need for a Ministerial guarantee to be given under section 2(4)(a) or for the body to have to satisfy the court on a case-by-case basis that the continuity of payments is reasonably secure.

#### What isn't covered by section 2(4)?

36. Section 2(4) does not cover periodical payments self funded by the Motor Insurers' Bureau, medical defence organisations, offshore insurers or private defendants as none of these payments attract statutory protection under the FSCS.
37. Section 2(4) also does not cover self-funded payments from a liability insurer where the contract of insurance between the defendant and liability insurer is one of the following classes of insurance:
- aircraft
  - aircraft liability
  - ships
  - liability of ships
  - goods in transit
  - credit.
38. With the exception of aircraft and ship liability, such contracts of insurance are unlikely to be relevant in this context as they are concerned with loss against property rather than persons.
39. This does not mean that courts cannot order periodical payments against these defendants and insurance bodies. They may be able to provide

statutorily secure periodical payments by purchasing an appropriate annuity from a life office for the benefit of the claimant, thus attracting the full protection of the FSCS under section 4(1) and (2) of the 1996 Act (but see para 52 below). Alternatively, it is open to these bodies to satisfy the court that they can offer a method of funding, other than one of those deemed secure under section 2(4), that is reasonably secure.

#### Security terms of an order for periodical payments

40. Rule 41.9 covers the security terms of an order for periodical payments.

The court must simply specify in the order that the payments are to be funded in accordance with section 2(4) (unless it permits an alternative method of funding), and does not need to enquire into how the payments are to be made (e.g. by self-funding or an annuity) or the type of investment to be used, or to specify this in the order. It will be the responsibility of the defendant or his insurer to ensure that the payments reflect the order made, however they are funded, and they will be in breach of the order should they fail to do so.

41. It is a matter for the defendant or his insurer to decide what form of funding to use to meet the terms of the order. Where the defendant or insurer is covered by section 2(4), they can choose to meet the order by purchasing an annuity or by self-funding, and it will not be necessary to identify a specific annuity policy at the time of the order. This is intended to give defendants and their insurers (who will carry the investment risk) maximum flexibility to choose whatever funding arrangements are most appropriate while ensuring the security of these arrangements. For example, a defendant may wish to self-fund for a short period until a change in market conditions or the availability of a new product on the market make it preferable to buy an annuity. Where the defendant or liability insurer is not covered by section 2(4), they will have to purchase an appropriate annuity for the claimant, unless the court has approved an alternative method of funding (but see para 52 below).

42. There may be circumstances where the defendant wishes to fund periodical payments in a way that is not defined as reasonably secure under section 2(4). Examples may be where a large corporation wishes to self fund payments from its own resources; where the case involves the Motor Insurers' Bureau which is funded by the insurance industry; or if a new type of financial instrument that is not covered by section 2(4) comes onto the market. In any such case, the court must of course be satisfied that the continuity of the payments is reasonably secure. Rule 41.9(2) and paragraph 3 of the Practice Direction set out the criteria which the court must be satisfied are met before it can order periodical payments under an alternative method of funding. The alternative method must still meet the terms of the order made. Rule 41.9(3) provides that where the court is satisfied of the security of an alternative method of funding, the order for periodical payments must specify the method of funding to be used.

43. Where the court is not satisfied by the security of the proposed alternative method of funding, section 2(5)(a) of the 1996 Act allows it to order the party responsible for the payments to secure their continuity by using a method under section 2(4). Section 2(5)(b) and (c) allows the court to make provision about funding by methods that aren't secure under section 2(4) (for example by requiring an annuity to be purchased before the order takes final effect).

#### Security terms of settlements

44. Other than in cases involving children and patients (where the consent of the court will always be required), it will of course be open to the parties to settle a claim on whatever terms they choose. However, if they wish the terms of the settlement to be embodied in a consent order made by the court, before making that order the court will need to be satisfied that the continuity of the payments is reasonably secure, and the requirements of Rule 41.8 will need to be satisfied.

#### Changes to methods of funding

45. There may be circumstances in which the defendant or insurer wishes to change the method of funding. This must not affect the amount of the payments. Where the defendant or insurer is changing to a method of funding which falls within the secured categories of 2(4) (for example, where a defendant's insurer who has been self-funding decides instead to purchase an annuity), there will be no need to obtain the court's approval as the new method of funding will continue to meet the terms of the order.
46. However, if the defendant or insurer wishes to change to a method of funding which does not fall within section 2(4), section 2(7) of the 1996 Act requires them to seek the court's approval that the continuity of payment is reasonably secure under the new method. The need to do this might arise in two situations: firstly where the defendant or insurer wishes to change from a secured method of payment to one which is not secured, and secondly where the defendant wishes to change from one non-secured method of payment (specified in the order) to another.
47. Section 2(5)(d) enables an order for periodical payments to include provision allowing a party to bring the matter back before the court in these situations so that it can consider the proposed method of funding (this is not intended to prevent a party making an application of this nature where the order does not contain specific provision for him to do so). Any change to the method of funding that is not secured under section 2(4) and which has not obtained the approval of the court will be a breach of the court order.

#### **Funding periodical payments**

48. Where a defendant or his insurer is ordered to make payments in accordance with section 2(4) of the 1996 Act, the court will not need to be

concerned with how the payments are to be made in terms of the form of funding, and, if funding is to be by an annuity, with the terms of the annuity to be used. As indicated at para 40 above, the defendant will have to ensure that the payments reflect the order made, and will be in breach should they fail to do so.

49. Periodical payments are usually funded in one of two ways:

a) Annuity based periodical payments

The defendant or defendant's liability insurer buys an annuity for the claimant in order to provide a stream of income to meet the level of payments specified in the court order or agreement. The annuity could be bought in the name of the claimant or held by the defendant who would then pass the relevant periodical payments to the claimant. Payments made in either of these ways are statutorily protected under the FSCS and are considered to be "reasonably secure" for the purposes of section 2(3) of the 1996 Act.

If the annuity will meet the required payments in full, the defendant (or insurer) thereby discharges their liability to the life insurer who has provided the annuity. However, in so far as the annuity does not meet the payments in full then a residual liability for the balance remains with the defendant (or insurer), who will need to use another method (e.g. self-funding) or a different annuity to fund that element.

b) Self-funded periodical payments

The defendant or defendant's liability insurer makes the payments directly from their own resources (however internally invested) as they become due under the court order or agreement. In this funding scenario, the liability to make payments continues to rest with the defendant/ insurer. It should be noted that only self-funded payments from certain sources (government/ health service bodies and most liability insurers) are protected by statute and are therefore considered to be "reasonably secure" under the 1996 Act (see section on security of payments above). The Financial Services Authority has confirmed that self-funding by a general insurer would be permissible under its regulations.

Types of annuity

50. There are four main types of annuity, index-linked, level, fixed annual escalation, and with-profits. Because of section 2(8) of the 1996 Act (see para 30 above) the most relevant in the context of periodical payments is an index-linked annuity that varies annually in accordance with the Retail Prices Index Under FSA permitted link and close matching regulations, other bases for index-linked annuities are not currently permitted.

a) Index linked annuities provide for the payments to escalate in line with an inflationary index, thus providing inflation proof payments. At present, only RPI linked annuities are permitted.

- b) Level annuities provide a fixed annual amount of income.
- c) Fixed escalation annuities provide an amount of income which increases by a fixed percentage annually.

Neither level or fixed escalation annuities are likely to be able to meet the required level of payments in a periodical payments order or agreement in isolation. However, they could be used to meet part of the required payments as part of a broader funding package.

- d) With-profits annuities provide a stream of income, the amount of which depends on the performance of the with-profits fund held by the company. A specified minimum level of income is usually guaranteed, irrespective of performance.

- It is very unlikely that any with-profits annuity would be able in isolation to guarantee to meet the terms of an order for periodical payments. To do so, the guaranteed minimum level of income would need to match the level of payments specified in the order *and* be tied to the RPI.
- It is also important to note that if a with-profits annuity provider were to fail, the guaranteed income of the annuity would be covered under the FSCS together with an amount for future benefits or bonuses in so far as these may be attributed a value under the winding up regulations. The FSCS will not cover under-performance of the with-profits fund.
- But it would be possible for a defendant's liability insurer to meet the terms of an RPI linked order with a with-profits annuity by purchasing it in its own name and passing the appropriate amount of payments onto the claimant. The insurer could retain any profit over the level of payment specified in the order but would have to make up any shortfall below that level. As these payments would be made directly from the liability insurer to the claimant, they would effectively be self-funded and therefore still attract the protection of the FSCS.

51. Annuities can, in principle, be very flexible, and there are various options available to meet the particular terms of an order or agreement. For example, annuities can be payable immediately or can be deferred (i.e. to become payable from a predetermined future date or on the happening of a defined future contingency). Whenever the annuity commences, it is possible for payments to be guaranteed for a minimum period, regardless of when the annuitant dies (for example where compensation for loss of earnings extends to a dependant - see para 28 above). It is also possible for payments to be "stepped" to provide an increase in payments on a stated date (e.g. where a child claimant reaches majority) or every stated number of years.

#### Availability of index-linked Government securities after 2035

52. At present, all existing index-linked Government securities will have expired by 2035. So index-linked annuities are only guaranteed to escalate in line with RPI until that date. Annuity contracts therefore provide for escalation to switch to a Limited Price Index if in future (i.e. after 2035) it becomes impossible for the provider to match its liabilities with appropriate index-linked assets. The contract prescribes a maximum percentage inflation figure (at present typically 1-5%) that will apply in these circumstances. The payments will still inflate by RPI if this is lower than the maximum figure at the time. If in future the annuity purchased does not provide the payments required to meet the terms of the order, then liability for meeting the shortfall remains with the liability insurer. The insurer is free to decide how best to ensure that the required payments will continue to be made. Three possible broad options available to insurers to deal with this issue are as follows:

- a) to self-fund payments in the short term until such time as it may become possible to purchase RPI linked annuities that are not time limited,
- b) to make some other financial arrangement that will discharge the liability in full (e.g. an index-linked derivative "inflation swop"),
- c) to buy an annuity, but make provision if necessary to make up the difference in the event that it does not meet the required payments.

### **Tax treatment of periodical payments**

53. Under section 329AA of the Income and Corporation Taxes Act 1988 (as amended by section 100 of the Courts Act 2003) periodical payments received in respect of damages for personal injury are exempt from income tax. This reflects the position which applied in relation to structured settlements prior to the provisions in the 2003 Act, and is in contrast to the tax treatment of a lump sum, where any income received from its investment is liable to income tax (although the capital remains tax free).

54. The tax exemption applies where payments are self-funded or where they are made under an annuity purchased for the claimant by the person by whom the payments would otherwise fall to be made. This applies whether the annuity is purchased for the claimant or whether it is owned by the defendant or some other person who holds the payments on trust for the claimant. Section 329AA(3) ensures that where the defendant/ insurer initially self-funds but subsequently changes the method of funding to an annuity, payments under the new method of funding remain tax exempt (even though an annuity is not specifically provided for in the order). Section 2 of the 1996 Act permits such a change without court approval.

55. The exemption also extends to:

- orders and agreements where variation has taken place (under s 329AA (3))

- periodical payments made under section 2 of the Damages Act 1996 where the claim was brought under the Fatal Accidents Act 1976 (under s 329AA (6))
- foreign orders for periodical payments in respect of personal injury (including claims under the Fatal Accidents Act and the Law Reform (Miscellaneous Provisions) Act 1934) (under s 329AA (7(a)))
- periodical payments made by the Motor Insurer's Bureau under the Untraced Drivers and Uninsured Drivers Agreements (under s 329AA-)
- payments made on account and interim payments (under s 329AA (7(b))).

56. The tax exemption does not apply to periodical payments made in respect of damages other than personal injury. It also only applies to periodical payments in the hands of the claimant or someone receiving payments on behalf of a claimant. If, for example, an insurer is holding an annuity in its own name to cover possible future variation, or using a with-profits annuity to self-fund periodical payments, the proportion of the annuity income that is not payable to the claimant will be liable for tax.

57. Section 329AA (2) (a) provides that the tax exemption applies only to the person entitled to the damages under the agreement or order (i.e. the claimant). If the periodical payments carry on after the death of the claimant for the benefit of the claimant's dependants, they will lose their tax free status and will be liable for income tax. If the payments are provided by way of a life annuity purchased from a life insurance company, then the successor recipient will almost certainly be entitled to a capital element, and only the income element will be taxable. However, self-funded payments will not involve a capital element, and thus the payments will be taxable in full.

A link is attached to Section 329AA of the Income and Corporation Taxes Act 1988 - [http://www.inlandrevenue.gov.uk/taxes act 2002/vol 02/ictapt07/ictapt07b-22.htm](http://www.inlandrevenue.gov.uk/taxes%20act%202002/vol%2002/ictapt07/ictapt07b-22.htm)

58. Sections 329AA and 329AB of ICTA (as amended by the Courts Act 2003) have been rewritten as sections 731 to 734 of the Income Tax (Trading and Other Income) Act (ITTOIA). In the main, ITTOIA does not change the effect of the law. So income that is taxable or exempt under the existing legislation remains taxable or exempt under ITTOIA.

A link is attached to the Act and the explanatory notes.  
<http://www.inlandrevenue.gov.uk/rewrite/index.htm>

### **Assignment or charge of right to receive payments**

59. Section 2(6) of the 1996 Act prevents the assignment or charge of the right to receive periodical payments unless the court that made the original order is satisfied that there are special circumstances that make it necessary. This is intended to avoid the possibility of claimants receiving less than the true value of the award as a result of their assigning their right to receive the payments in return for a lump sum.

60. Rule 41.10 requires the court in considering whether to permit an assignment or charge to have regard to a number of factors set out in paragraph 4 of the Practice Direction. These comprise:

- whether the capitalised value of the assignment or charge represents value for money;
- whether the assignment or charge is in the claimant's best interests, taking into account whether those interests can be met in some other way; and
- how the claimant will be financially supported following the assignment or charge.

61. These restrictions on claimants' ability to assign or charge the right to periodical payments does not affect their ability to borrow against their future income. Unsecured loans will thus be permissible, but not secured loans that put the claimant's right to receive payments at risk.

## **Periodical payments and Part 36 of the Civil Procedure Rules**

### Introduction

62. The Civil Procedure (Amendment No 3) Rules 2004 make amendments to Part 36 to ensure that the scheme relating to the costs consequences of offers to settle and payments into court can work in cases involving periodical payments.

63. An effective system of offers to settle plays an important part in encouraging the early settlement of cases. Part 36 accordingly provides financial incentives, in the form of provisions on costs, to both parties to make and accept offers. In particular, rules 36.20 and 36.21 impose adverse costs consequences on a claimant who fails to do better at the trial than a defendant's offer or payment into court, and on a defendant where the claimant does better at the trial than proposed in his or her offer.

64. Where both the refused offer and the court's award are made in terms of a lump sum, Part 36 will operate as now, and it will be a straightforward matter to see whether or not the award is higher than the payment or offer. Where the offer and the award are both in terms of periodical payments it should usually be reasonably straightforward. However, where the offer is in terms of a lump sum and the award in terms of periodical payments (or vice versa, or a mixture of the two) it may be difficult when considering costs to say whether or not a party's offer has been beaten by the award.

65. Also, where part or all of an offer consists of periodical payments, it will not be possible for a party to make a payment into court in relation to the

periodical payments element. In these circumstances, any lump sum element in the offer should continue to be paid into court.

### The Rule amendments

66. A new Rule 36.2A has been added which applies to all future pecuniary loss claims. Rule 36.2A(4) permits either party to offer to settle a future pecuniary loss claim on the basis that damages will be awarded in the form of a lump sum, or in the form of periodical payments, or a combination of both.

67. Rule 36.2A(5) requires any such offer to state:

- the amount of any lump sum element
- what part of the offer relates to periodical payments
- the amount and duration of the periodical payments
- the amount of any payments for substantial capital purchases and when they are to be made
- that each amount is to vary by reference to the Retail Prices Index (or to some other named index, or that it is not to vary by reference to any index)
- that the periodical payments will be funded in a way that is reasonably secure in accordance with section 2(4) of the 1996 Act or if not, how the payments are to be paid and secured

68. In addition, the offer may also state:

- what part of the offer relates to future pecuniary loss in the form of a lump sum
- what amounts (if any) relate to other damages in the form of a lump sum

69. These lists focus on the key elements which need to be included in a Part 36 offer. It does not require all the details which are stipulated in Rule 41.8 to be set out in the offer. As noted at paragraph 44 above, if the parties wish the terms of a settlement to be embodied in a consent order made by the court the requirements of Rule 41.8 will also need to be satisfied.

70. In addition, Rule 36.2A(7) requires that where an offer includes both a lump sum and periodical payments, the claimant may only accept the offer as a whole, and not in part alone.

71. Rule 36.2A(2) provides that where the defendant's offer involves a lump sum, it will not have costs consequences under Part 36 unless a Part 36 payment of the lump sum element is also made. Where both a Part 36 offer and a Part 36 payment are made, Rule 36.2A(3) requires the offer to include details of the payment, and provides that Rules 36.11(1) and (2) and 36.13(1) and (2) apply as if there were only a Part 36 offer. This means that periods of time relating to the acceptance of offers are calculated from the date of the Part 36 offer, not the payment into court of the lump sum element.

72. Rule 36.2A(6) provides that where a Part 36 payment includes a lump sum for future loss, the Part 36 payment notice may state the amount of that lump sum.

73. A number of consequential amendments are made to the Part 36 Rules to accommodate the provisions in Rule 36.2A. These ensure that that Rule is taken into account in the following areas:

- Rule 36.4 on a defendant's offer to settle the whole of a claim which includes both a money claim and a non-money claim
- Rule 36.10 on offers to settle made before the commencement of proceedings.
- Rule 36.20 on costs consequences where the claimant fails to do better than a Part 36 offer or payment
- Rule 36.21 on costs and other consequences where the claimant does better than he proposed in his Part 36 offer
- Rule 36.23 on deduction of benefits

#### **Variation of periodical payments orders and agreements**

74. Section 2B of the 1996 Act gives the Lord Chancellor the power to specify by Order the circumstances in which an order or agreement between the parties in respect of periodical payments may be varied by the court. In the case of agreements, section 2B(2) requires that the agreement to provide for periodical payments must expressly permit a party to apply to the court for variation in the relevant circumstances. These provisions do not prevent the parties from agreeing variation on whatever terms they choose if they do not wish the court to be involved, either in making a consent order reflecting the agreement or in deciding any subsequent application to vary.

75. The provisions on variation will apply only to orders or agreements in proceedings issued on or after 1 April 2005.

76. The Damages (Variation of Periodical Payments) Order 2005 sets out the provisions governing orders and agreements providing for variation. Article 2 of the Order sets out the terms under which the court may make a variable order (Article 9 contains similar provisions in relation to agreements between the parties). These are where there is proved or admitted to be a chance that at some definite or indefinite time in the future the claimant will

- (a) as a result of the act or omission which gave rise to the cause of action, develop some serious disease or suffer some serious deterioration, or
- (b) enjoy some significant improvement in his physical or mental condition, where that condition had been adversely affected as a result of that act or omission.

77. In these circumstances, the court will be able to make a variable order of its own initiative, on application by a party, or with the agreement of all the parties.
78. These provisions largely reflect those which currently apply to provisional damages under section 32A of the Supreme Court Act 1981, except that variation will be possible for significant improvement as well as deterioration; and it will be open to defendants to apply as well as claimants. In order to ensure consistency between the two regimes, Section 2B(4) of the 1996 Act enables the Lord Chancellor in making an Order on variation to apply or amend legislation on provisional or further damages. Article 4 of the Order preserves the court's ability to make a provisional damages order in addition to a variable order.

### Contents of variable order

79. Article 5 of the Order provides that where the court makes a variable order:

- a) the damages must be assessed or agreed on the assumption that the disease, deterioration or improvement will not occur
- b) the order must specify the disease or type of deterioration or improvement
- c) the order may specify a period within which an application for it to be varied may be made
- d) the order may specify more than one disease or type of deterioration or improvement and may, in respect of each, specify a different period within which an application for it to be varied may be made
- e) the order must provide that a party must obtain the court's permission to apply for it to be varied, unless the court otherwise orders

80. Where the court specifies a period within which an application to vary can be made under c) or d) above, Article 6 enables a party to apply for the relevant period to be extended, but without such an application being treated as an application to vary. No restriction is placed on the number of applications to extend that may be made, nor on the number of applications for permission to apply for variation that may be made. However, Article 7 provides that a party (having been granted permission) may make only one application to vary a variable order in respect of each specified disease or type of deterioration or improvement.

### Variable orders and liability

81. Article 3 of the Order requires that where the court is considering whether to make a variable periodical payments order against an uninsured private defendant, it must consider the defendant's likely future financial resources. In order to meet the security provisions of the order, an uninsured defendant will probably have to purchase an annuity for the claimant. However, the liability for any increased payments on variation will continue to lie with the defendant. As it might be many years before an application for variation is made, and as the individual's future financial resources could not be guaranteed, the court might consider that a claimant's possible future needs should be met in another more secure way rather than by a variable order.

### Case file

82. Where the court makes a variable order, Article 8 of the Order requires the court, the legal representatives of the parties and, where the parties are insured, their insurers to preserve various case file documents. This is necessary to ensure that a subsequent application to vary the variable

order can be dealt with effectively and expeditiously without unnecessary costs. Guidance has been issued to court staff about the preservation of the case file.

#### Contents of variable agreement

83. Article 9(2) contains similar provisions to Article 5 b), c) and d) in relation to variable agreements, and also reflects section 2B(2) of the 1996 Act by requiring the agreement to state expressly that a party to it may apply to the court for its terms to be varied. It also requires the court's permission to be sought for any application for the terms of the agreement to be varied.

#### Applications for permission

84. Article 10 of the Order sets out the evidence that must be provided and the procedures that must be followed in relation to an application for permission to apply for a variable order or agreement to be varied. Paragraph (2) and (3) require the claimant to serve notice of an application on the defendant's insurers or defence society (where these are known) as well as the defendant. Article 10(4) then allows the respondent 28 days to serve written representations on the applicant and file them with the court.

85. Article 10(5) provides for the court to deal with an application for permission without a hearing. If permission is refused, Article 11 allows the applicant within 14 days of service of the refusal to request that the decision is reconsidered at a hearing. No appeal is allowed in the event that permission is still refused after reconsideration. If permission is granted, Article 12 requires the court to give directions in relation to the substantive application to vary, including directions as to the date by which the application must be served and filed and as to the serving and filing of evidence. No appeal is allowed against an order granting permission.

#### Orders for variation

86. Article 13 of the Order provides that if the court is satisfied that the specified disease, deterioration or improvement has occurred, and that it has caused or is likely to cause an increase or decrease in the pecuniary loss suffered by the claimant, it may make provision:

- for the amount of annual payments to be varied from an appropriate date (which cannot precede the date of the application for permission or (if permission is not required) the date of the application to vary
- about how each payment is to be made during the year and at what intervals

- for a lump sum to be paid in addition to the existing or varied periodical payments
87. The provision in relation to a lump sum has been included to ensure that the courts have the flexibility to order what is most appropriate to meet the claimant's needs. For example, it may be that the development of the condition which has led to an application to vary necessitates the purchase of particular equipment for which a lump sum is more appropriate either instead of or alongside additional periodical payments.
88. Article 13 does not explicitly repeat the requirement in Article 2 and 9 that the specified disease, deterioration or improvement must be the result of the act or omission which gave rise to the cause of action, as this is regarded as clearly implicit.
89. Article 13(2) applies all relevant provisions of section 2(3) to (9) of the 1996 Act to variable orders in the same way as to non-variable orders. These comprise the provisions on security of payments, assignment, alteration of the method of payment and indexation (see the guidance on which above).

## **Annex A**

### **Statutory Instruments**

The provisions on periodical payments are contained in the following Statutory Instruments, which are referred to in the guidance:

- The Civil Procedure (Amendment No.3) Rules 2004 (2004 No.3129), which amend Part 36 and Part 41 of the Civil Procedure Rules
- 37<sup>th</sup> Update of the Civil Procedure Rules (published December 2004)
- The Damages (Variation of Periodical Payments) Order 2005 (2005 No. 841)

The Damages (Government and Health Service Bodies) Order 2005 (2005 No. 474)

The Courts Act 2003 (Commencement No. 10) Order 2005 (2005 No.910 (C.39))

The Courts Act 2003 (Transitional Provisions, Savings and Consequential Provisions) Order 2005 (2005 No. 911)

### **Consequential amendments to other Practice Directions**

A number of consequential amendments have been made to Practice Directions other than those on Part 36 and Part 41. These comprise:

- Amendments to Practice Direction 21 on Children and Patients

Amendments are made to paragraph 6 of PD21 in relation to the approval by the court of settlements or compromises by or on behalf of a child or patient which involve periodical payments. These delete the existing procedure relating to structured settlements in paragraph 6.4 and replace it with the requirement for the court to be satisfied that the parties have considered periodical payments, and for the claim (if the settlement is reached prior to proceedings having been commenced) or the application (if settlement is reached after proceedings have commenced) to set out the terms of the settlement or compromise or attach a draft consent order, both of which must satisfy the requirements of Rule 41.8 and 41.9 as appropriate.

In seeking the court's approval, the parties are also required to provide the court with a copy or record of any financial advice in addition to the other documents required under the Practice Direction. This does not impose a requirement to obtain financial advice, but merely to provide details of any advice received.

- A consequential amendment is made to paragraph 3A of Practice Direction 29 on case management in the multi-track to substitute a provision on periodical payments for the existing one on structured settlements
- Consequential amendments to paragraph 13.2 and 13.5 of Practice Direction 52 on appeals involving children and patients substitute provisions on periodical payments for those on structured settlements

## **Annex B**

### **Periodical payments and means tested benefits**

Receipt of personal injury compensation can affect eligibility for social security and other benefits. In the past, there were significant differences in the way that the various forms of payment were treated when assessing eligibility for means tested benefits. This position created a particular disincentive to consent to periodical payments. In October 2002, the treatment of periodical payments and lump sums held in trust were brought into line. The impact of the form of payment on eligibility for means tested benefits is therefore no longer a significant factor in considering whether a periodical payment or lump sum order is the more appropriate way of meeting future losses. The present position is set out below for information.

#### Income Support (following the Social Security Amendment (Personal Injury Payments) Regulations 2002, SI number 2442)

For the purposes of assessing eligibility for income support (including Council Tax Benefit, Housing Benefit, Jobseekers' Allowance), both periodical payments and payments made from trusts whose funds are derived from lump sum personal injury awards are disregarded in their entirety when intended and used for items other than everyday living expenses; and £20 a week used for such expenses is also disregarded. The effect is that damages for special needs such as care costs are protected, but damages to replace lost earned income are generally taken into account in assessing entitlement to benefits. The capital value of annuities and lump sums held in trust is completely disregarded.

To facilitate the application of these regulations, Civil Procedure Rule 41.8 requires orders for periodical payments to identify the annual amount awarded for future loss of earnings and other income, and that awarded for care and medical costs and other recurring or capital costs.

Link to Social Security Amendment (Personal Injury Payments) Regulations 2002, SI number 2442 -<http://www.hms0.gov.uk/si/si2002/20022442.htm>

#### Local authority provision of residential care (following National Assistance (Assessment of Resources) (Amendment) (No. 2) Regulations 2002)

These regulations reflect those for income support. For the purposes of assessing liability to contribute towards local authority assistance, periodical payments and payments made from trusts whose funds are derived from lump sum personal injury payments are disregarded in their entirety when intended and used for items other than those covered by the local authority's "standard rate", and £20 a week used for such expenses is also disregarded. The standard rate will usually include care and accommodation costs. The capital value of annuities and lump sums held in trust is completely disregarded.

To facilitate the application of these regulations, Civil Procedure Rule 41.8 requires orders for periodical payments to identify the annual amount awarded for future loss of earnings and other income, and that awarded for care and medical costs and other recurring or capital costs.

Link to National Assistance (Assessment of Resources) (Amendment) (No. 2) Regulations 2002, SI number 2531 <http://www.hmsso.gov.uk/si/si2002/20022531.htm>

Personal injury damages held in the Court of Protection Slightly different rules apply to personal injury damages administered by the Court of Protection. In these cases, as above, the capital value of the damages is disregarded for means testing purposes. Interest accruing to personal injury damages held in court and any payment out of court is also disregarded. Although it is unlikely that periodical payments will be held or administered by the Court of Protection, their treatment will remain the same as that above. For more information on the benefits position of personal injury damages held in court, the Public Guardianship Office has a useful page - [http://www.publictrust.gov.uk/personal\\_injury.html](http://www.publictrust.gov.uk/personal_injury.html)

### **Periodical payments and insolvency**

Periodical payments in respect of personal injury damages are subject to special provisions under insolvency law. The intention behind the amendments in new section 4 of the Damages Act as inserted by section 101 of the Courts Act was to ensure that the bankruptcy treatment of periodical payments should strike a balance which recognises that payments for medical and care costs should be protected, but does not otherwise give those in receipt of periodical payments preferential treatment over bankrupts who are not in receipt of personal injury damages.

#### Periodical payments received pre-bankruptcy

Under section 283 of the Insolvency Act 1986, any money in the hands of the bankrupt at the date of the bankruptcy order will vest in the trustee in bankruptcy for the benefit of creditors. Periodical payments that have already been received by the bankrupt at the date of the order are not exempt from this provision and will therefore form a part of the bankrupt's estate. Periodical payments used to purchase another asset (i.e. a car, second home etc) will also vest in the estate.

However, under section 101 (4) of the Courts Act, the right to receive future periodical payments, and any annuity providing those payments, will not form part of the bankrupt's estate. This means that the bankrupt will continue to receive periodical payments during and after the period of bankruptcy.

#### Periodical payments received post bankruptcy order

Under section 310 of the Insolvency Act 1986, the trustee in bankruptcy may claim any income received *after* the date of bankruptcy for the bankrupt's estate by way of an Income Payments Order.

As periodical payments are treated as *income* for the purposes of insolvency law, they can be the subject of an Income Payments Order. However, under section 101(4)(c) of the Courts Act 2003, an Income Payments Order cannot be made in respect of periodical payments for care and medical costs. Payments in respect of loss of earnings are not exempt.

To facilitate the application of these provisions, Civil Procedure Rule 41.8 requires orders for periodical payments to identify the annual amount awarded for future loss of earnings and other income, and that awarded for care and medical costs and other recurring or capital costs.

## **Protection for payments under the Financial Services Compensation Scheme**

1. The Financial Services Compensation Scheme (FSCS) ([www.fscs.org.uk](http://www.fscs.org.uk)) was set up under section 213 of the Financial Services and Markets Act 2000. It acts as a safety net for customers of financial services firms. It pays compensation if an authorised firm (that is one authorised to carry out business by the Financial Services Authority ([www.fsa.gov.uk](http://www.fsa.gov.uk))) is unable to pay claims against it, usually because it has gone out of business. The Scheme covers deposits, insurance, investments, mortgage arranging and advice, and general insurance mediation and is financed by levy raised against its participant firms.

### **The standard provisions of the FSCS**

2. The FSCS provides compensation to eligible policyholders if they are insured by authorised insurance firms under contracts of insurance issued in the UK, or in some cases the EEA, Channel Islands or Isle of Man. The Scheme covers general and life insurance and is triggered if an insurance firm becomes insolvent. The amount of protection that a policyholder can receive from the FSCS generally depends upon the type of insurance policy:
  - Certain compulsory insurance (e.g. employers' liability, motor insurance) is fully protected
  - Non-compulsory insurance (e.g. travel insurance, home insurance) - is covered 100% of the first £2000 and 90% of the remainder
  - Life insurance (e.g. annuities) is covered 100% of the first £2000 and 90% of the remainder

From 1 January 2004, FSCS protection was extended to Lloyds' in the event that the central fund is insufficient.

### **The scheme as extended by section 4 of the Damages Act 1996**

3. Section 4 of the Damages Act 1996, as substituted by the Courts Act, provides enhanced protection under the FSCS for periodical payments. This ensures that the continuity of periodical payments is fully protected under the Financial Services Compensation Scheme where self-funded by any insurer or funded by an annuity.
4. The effect of **sections 4(1) and 4(2)** are that where the claimant is the beneficial owner of an annuity (e.g. the claimant is the policy-holder) the payments under that annuity are protected in full (rather than 90%) under the Scheme.
5. **A more technical explanation of Sections 4(1) and (2):** Section 4(2) extends the standard protection under the Scheme to the whole of the

periodical payments. Under section 4(1) this uplifted protection applies where a claimant has a right to receive periodical payments, and that right is protected under the FSCS - in other words, where there is an annuity contract in place between the insurer and the claimant which enables the claimant's right to periodical payments to be satisfied.

6. As explained in the main body of the text, **sections 2(3) and 2(4)** will allow defendants and their insurers to fund periodical payments in whatever way they choose, provided the continuity of the payment is adequately secure. Protection under the FSCS will constitute adequate security. There are a number of funding options that may be relevant. For example, a general insurer may prefer to fund the payments directly from its own resources rather than purchase an annuity, perhaps purchasing an annuity at a later date when annuity rates are more favourable. Or the insurer may wish to purchase an annuity in its own name, and then pass the periodical payments to the claimant. This may be attractive, for example, where there is a possibility of the payments being reduced on appeal or variation.
7. The standard provisions of the FSCS will not operate effectively to protect the claimant's right to continue to receive payments in the event of the failure of the defendant's insurer. For example, in the event of the failure of a defendant's insurer who was self-funding payments, the defendant rather than the claimant would be the policyholder under that contract of insurance and it would be he, not the claimant, who was entitled to receive compensation under the FSCS. In addition, if the defendant were a large firm, it would not be eligible to claim under the FSCS. And unless the general insurance policy in question was one of compulsory insurance (motor or employer's liability), the standard provisions of the scheme would only protect 90% of the payments due (plus 100% for the first £2000). Similar issues arise where the insurer owns the annuity that is funding the claimant's periodical payments. In these circumstances, the claimant is not the policy holder of the annuity and so would have no direct claim under the FSCS.
8. The effect of **sections 4(3) and (4)** is to extend full protection for the claimant to these alternative methods of funding. They provide for recipients of periodical payments to have a direct claim under the FSCS, and for that claim to cover 100% of the payments, when any arrangement is in place to fund periodical payments that attracts the protection of the FSCS - i.e. where it is underpinned by an annuity or a relevant general insurance contract (certain categories of general insurance, such as aircraft or shipping liability, are not protected by the FSCS).
9. The **technical explanation of section 4(3) and (4)** is set out below. Section 4 (3) provides that section 4 (4) applies:
  - where a person (the claimant) has a right to receive periodical payments from another person (the defendant); and
  - where a third person (the insurer) is required by an arrangement with the defendant to make payments in satisfaction of the claimant's right to receive periodical payments or to enable that right to be satisfied; and

- where the claimant's right to receive payments would be protected under the FSCS if it arose from the same kind of arrangement as that between the defendant and the insurer but made between the claimant and the insurer. Where the insurer is the owner of the annuity bought to fund payments, this arrangement will be the annuity contract between themselves and the Life Office; and where the general insurer is self funding, this arrangement will be the general insurance contract between the defendant and their insurer (it is not intended to suggest that the claimant is deemed to have the same *class* of general insurance as that underpinning the actual arrangement - this would not make sense for example in the case of third party liability insurance.)
10. Section 4(4) (a) provides that in the above circumstances, the claimant shall be deemed to be protected by an arrangement of the same kind as the one that is actually in place between the defendant and insurer (i.e. annuity contract or general insurance contract). The effect of this is that the claimant is given the right to a direct claim under the FSCS, as if he or she were the policyholder of the insurance contract. Section 4(4)(b) extends the protection of the claimant's payments to 100% under the FSCS, and section 4(4)(c) extinguishes any other potential claim.

## Appendix G

### Expected increase in reserves compared to Ogden

#### Figures supplied by Anthony Carus

##### MALE

Multiplicand: £10,000 p.a.

Retirement Age: 65

Age	Loss for life		% increase
	Reserve	Ogden	
20	429,463	313,000	37%
40	336,598	256,100	31%
60	212,552	169,800	25%

Age	Loss of Earnings		% increase
	Reserve	Ogden	
20	331,302	265,500	25%
40	209,453	180,500	16%
60	48,184	45,800	5%

Age	Loss of Pension		% increase
	Reserve	Ogden	
20	98,162	47,500	107%
40	127,146	75,700	68%
60	164,368	124,000	33%

##### Sensitivities for Reserves

Age	Loss for life		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	467,679	408,477	49%	31%
40	363,453	321,519	42%	26%
60	230,188	202,563	36%	19%

Age	Loss of Earnings		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	349,185	320,677	32%	21%
40	216,517	204,963	20%	14%
60	48,708	47,777	6%	4%

Age	Loss of Pension		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	118,494	87,800	149%	85%
40	146,935	116,557	94%	54%
60	181,480	154,786	46%	25%

##### FEMALE

Multiplicand: £10,000 p.a.

Retirement Age: 60

Age	Loss for life		% increase
	Reserve	Ogden	
20	441,040	322,700	37%
40	353,951	269,200	31%
55	268,121	211,000	27%

Age	Loss of Earnings		% increase
	Reserve	Ogden	
20	305,294	251,700	21%
40	174,770	155,400	12%
55	48,599	46,500	5%

Age	Loss of Pension		% increase
	Reserve	Ogden	
20	135,747	70,900	91%
40	179,180	113,800	57%
55	219,522	164,400	34%

##### Sensitivities for Reserves

Age	Loss for life		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	479,538	420,259	49%	30%
40	380,306	339,774	41%	26%
55	286,744	258,274	36%	22%

Age	Loss of Earnings		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	319,959	296,568	27%	18%
40	179,358	171,886	15%	11%
55	49,023	48,292	5%	4%

Age	Loss of Pension		% increase	
	Prudent	Aggressive	Prudent	Aggressive
20	159,579	123,691	125%	74%
40	200,948	167,887	77%	48%
55	237,720	209,982	45%	28%

Ogden multipliers at 2.5%  
Calculations as at 31 Dec 2005