Government Actuary's Department

Vnuk Impact Analysis

Executive Summary

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At GAD, we seek to achieve a high standard in all our work. We are accredited under the Institute and Faculty of Actuaries' Quality Assurance Scheme. Our website describes **the standards** we apply.

Overview

The Government Actuary's Department has been working with the Department for Transport to investigate the potential impact in the United Kingdom of a judgment by the European Court of Justice regarding compulsory motor insurance. This report summarises the analysis that has been carried out since 2017, including an external peer review by Grant Thornton UK LLP.

Purpose

1.1 This report has been prepared by the Government Actuary's Department ('GAD') at the request of the Department for Transport ('DfT'). The report provides a summary of all of the analysis carried out by GAD between 2017 and 2019 exploring the potential impact of the 2014 judgment by the European Court of Justice regarding compulsory motor insurance (the 'Vnuk judgment'). This report also refers to an external peer review of the work by Grant Thornton UK LLP ('GT').

1.2 The purpose of creating this summary is to help DfT to share information on the United Kingdom's ('UK') analysis of the Vnuk judgment. GAD understands that DfT intends to distribute this report to other government departments and partners in the European Union.

1.3 Other than DfT, no person or third party is entitled to place any reliance on the contents of this report, except to any extent explicitly stated herein. GAD has no liability to any person or third party for any action taken or for any failure to act, either in whole or in part, on the basis of this report.

1.4 The more detailed reports that fully describe GAD's analysis and GT's peer review are listed towards the end of this document. Other limitations on the use of and reliance on this work are also included in these documents.

Executive Summary

Background

1.5 On 13 August 2007 an accident occurred whereby Mr Vnuk, a worker on a farm in Slovenia, was injured as a result of being knocked off a ladder by a trailer attached to a tractor which was reversing across the farm. The pertinent facts of the incident are that i) the farm was on private property and ii) compulsory insurance had been purchased for the tractor in order to comply with national law in Slovenia, which was designed to satisfy the requirements of the European Commission's Motor Insurance Directive ('MID').

1.6 Mr Vnuk brought a claim for damages against the insurance company which had provided the compulsory motor insurance policy. The claim was initially rejected by the Slovenian courts but in 2014 the case was referred to the European Court of Justice which ruled in favour of Mr Vnuk.

1.7 As a result of the Vnuk judgement, the UK's current interpretation of the MID may no longer be correct. Current domestic legislation, the Road Traffic Act (1998), requires motor vehicles used "on a road or other public place" to have unlimited insurance cover for third party bodily injury losses ('TPI' claims), and a minimum of £1.2m cover for third party property damage losses. It does not require motor vehicles to be insured for incidents that occur on private land. A motor vehicle is defined as being "a mechanically propelled vehicle intended or adapted for use on the roads".

1.8 In the UK, any insurer providing compulsory third party liability insurance must be a member of the Motor Insurers' Bureau (MIB) which provides compensation to victims of uninsured and untraced drivers. A levy is charged to members to cover these costs.

1.9 DfT asked GAD to consider the impact of five potential courses of action following the Vnuk ruling:

Option 1a - Comprehensive Option with unlimited TPI liability: To modify domestic legislation to comply with the new interpretation of the MID. This would mean extending compulsory insurance to cover additional types of vehicle and to also cover the use of vehicles whilst on private land.

Option 1b - Comprehensive Option with limited TPI liability, MID minimum scenario: In addition to the modifications described in option 1a, further modify legislation to remove the requirement to provide unlimited liability for TPI claims, and instead replace it with a defined upper limit.

The level of the cap is based on the minimum amount as set out in the Motor Insurance Directive. The cap is prescribed in Euros. This has been converted to Sterling. This gives a cap of £1.1m per claimant and £5.3m per claim.

Option 1c - Comprehensive Option with limited TPI liability, £5m / £10m scenario: In addition to the modifications described in option 1a, further modify legislation to remove the requirement to provide unlimited liability for TPI claims, and instead replace it with a defined upper limit of £5m per claimant and £10m per claim.

Option 1d - Comprehensive Option with limited TPI liability, £25m / £50m scenario: In addition to the modifications described in option 1a, further modify legislation to remove the requirement to provide unlimited liability for TPI claims, and instead replace it with a defined upper limit of £25m per claimant and £50m per claim.

Option 2a - Amended Option with unlimited TPI liability: To modify the Road Traffic Act to comply with the proposals by the European Commission, in anticipation that the MID will be amended in the near future. Coverage would only be required to the extent that the vehicles operate on a road or other public place. The vehicles impacted are generally contained in the Miscellaneous vehicle category and include electric bikes and mobility scooters.

Results

1.10 There have been several iterations of GAD's analysis since 2017 which can be followed by referring to the Analysis Chronology section. The estimates below are the latest estimates requested by DfT and include the updated UK Motor Sport exposure considered in the analysis presented in March 2019. GT peer reviewed the analysis on the 10 July 2019 and concluded that "GAD's methodology and assumptions as described in the GAD Report are reasonable and fit for purpose given the data and information available".

1.11 The table below summarises GAD's estimate of the additional premiums which would be charged to supply Road Traffic Act compliant policies under the options. These figures are a forecast for the 2018 calendar year, which means that they include an allowance for exposure and claim trends (such as inflation) up to this date.

1.12 There is considerable uncertainty in the estimates presented below. This uncertainty is illustrated throughout the report using a range of sensitivity tests and is discussed briefly below.

	Change in premium costs for the UK 2.5% PIDR (£m)				
	Option 1a	**Option 1b**	**Option 1c**	**Option 1d**	**Option 2a**
Vehicle Category	**Comprehensive Option Unlimited TPI Liability** *(With Motor Sports adj.)*	**Comprehensive Option Limited TPI Liability MID minimum scenario** *(With Motor Sports adj.)*	**Comprehensive Option Limited TPI Liability £5m/£10m** *(With Motor Sports adj.)*	**Comprehensive Option Limited TPI Liability £25m/£50m** *(With Motor Sports adj.)*	**Amended Option Unlimited TPI Liability** *(With Motor Sports adj.)*
Existing - Motorcars	1,227	-902	-167	809	0
Existing - Motorcycles	65	-34	3	48	0
Existing - Business Vehicles	105	-312	-213	-82	0
Motor Sports	458	358	371	395	0
Other Business	198	145	155	184	0
Miscellaneous	8	7	8	8	7
Total (PIDR 2.5%)	**2,060**	**-737**	**157**	**1,363**	**7**
Impact of the option if PIDR was 1%					
Total (PIDR 1%)	**2,305**	**-1,320**	**-223**	**1,243**	**7**

1.13 The figures presented above were produced on a best estimate basis with no allowance for prudence or optimism and under the personal injury discount rate (PIDR) applicable at the time of the analysis. The PIDR directly impacts the level of compensation received by claimants. On the 5th August 2019 the PIDR changed from -0.75% to -0.25% in England and Wales. The PIDR in Scotland is -0.75% and is currently under review. The PIDR in Northern Ireland is 2.5%.

1.14 A lower PIDR directly causes higher claim settlements and, consequently, an increase in premiums. At the time the analysis was produced there was uncertainty concerning the future PIDR which was then under review. To help illustrate the uncertainty, GAD provided an estimate of the impact of the options based on a 1% PIDR. On a 1% PIDR basis larger savings are made when TPI liabilities are limited at the same fixed amounts. This is because a higher number of cases would be expected to exceed the cap.

1.15 The extension of compulsory insurance cover, option 1a, would increase premium costs for the UK by £2,060m on a 2.5% PIDR basis. The majority of the increased costs, £1,227m, would be borne by existing motorcar policy holders. A linear extrapolation of the figures presented above indicates that the total additional UK premium under option 1a on a -0.25% PIDR could be approximately 20% higher. The use of linear extrapolation cannot be used to provide approximate estimates for options that include TPI limits.

1.16 The extension to private land creates two additional sources of loss for insurers – legitimate claims due to increased exposure on private land, and new fraudulent claims. Under option 1a, the additional costs for existing Motorcars and Motorcycles due to fraud are expected to be £743m and £41m respectively on a 2.5% PIDR basis. This represents approximately 60% to 65% of the additional costs.

1.17 Under option 1b, the impact of the ruling on UK premiums would be a decrease of £737m on a 2.5% PIDR basis. Approximately 325 UK claims each year would be expected to exceed the limits based on a 2.5% PIDR. In this case the savings to UK premiums due to the introduction of the limits would exceed the increase to UK premiums due to the extended cover implemented following the ruling.

1.18 Under option 1c, the impact of the ruling on UK premiums would be an increase of £157m on a 2.5% PIDR basis. The higher limits would mean fewer claims would be expected to exceed the limits, approximately 75 claims each year based on a 2.5% PIDR. As a consequence, the increase to UK premiums as a result of the extended cover implemented following the ruling would exceed any savings to UK premiums due to the introduction of the limits under this option.

1.19 Under option 1d, the impact of the ruling on UK premiums would be an increase of £1,363m on a 2.5% PIDR basis. The higher limits would mean even fewer claims would be expected to exceed the limits, approximately 10 claims each year based on a 2.5% PIDR. The increased limits would further reduce savings to UK premiums.

1.20 Consideration should be given to the parties that would be liable for any costs beyond the limits of the insurance contract. The savings would be made to premiums and the cost would be incurred elsewhere. Furthermore, if limits were introduced insurance providers could offer cover beyond the minimum prescribed limits.

1.21 The impact of the ruling under option 2a is far less material, an increase of £7m. This would be borne by the owners of Miscellaneous vehicles.

Assumptions and Uncertainty

1.22 In order to assess the costs associated with the new risks as a result of the judgement GAD has made a number of assumptions about the losses that may arise, and how the insurance industry may develop suitable products.

1.23 Where possible, GAD has based these assumptions on relevant evidence which we were able to obtain during the course of the project. This may be quantitative data provided by the market participants, qualitative data from industry experts, or broader research which has been provided to GAD. In the absence of these data sources, we have used our judgement to guide our assumptions. Consequently, the estimates presented in this report are subject to a high-level of uncertainty. Actual future experience could differ to the assumptions selected as part of this analysis.

1.24 The sensitivities of the assumptions subject to the largest uncertainty under option 1a are described below. These estimates pre-date the adjustment from the update of the UK Motor Sport exposure.

- Increased claim frequency due to the extension of cover to private land – alternative reasonable estimates indicate the total additional UK premium (2.5% PIDR) could be 24% higher or 22% lower.

- Increased claim frequency due to the extension of fraud on private land – alternative reasonable estimates indicate the total additional UK premium (2.5% PIDR) could be 62% higher or 43% lower.

1.25 As demonstrated by these sensitivities, alternative reasonable assumptions could produce very different results. The figures have been presented in £m to allow the reader to consider the implications for all vehicle categories. When evaluating the results consideration should be given to spurious accuracy. For example, a sensible conclusion when considering the impact to UK premiums under Option 1a would be an estimate of around £1bn to £3bn of additional premiums on a 2.5% PIDR basis.

Analysis Chronology

This document provides a summary of the analysis undertaken by GAD and peer reviewed by GT. The more detailed reports that fully describe the work are as follows:

- Original Vnuk impact analysis (August 2017)

  This document describes the data, methodology and assumptions underlying the original model that GAD built to help explore the potential costs of the Vnuk Judgment. As well as providing a central estimate of costs, there is extensive work highlighting the uncertainties surrounding this figure.

- Effect of introducing a cap on third party bodily injury claims (December 2017)

  DfT subsequently commissioned GAD to estimate the impact on our analysis if compulsory motor insurance was further modified to remove the requirement to provide unlimited liability for third party bodily injury claims, and instead replace it with a defined upper limit. This document explores the potential effects of such a change.

- Effect of increasing motor sports exposure (March 2019)

  In the most recent analysis performed by GAD, DfT requested that the assumptions relating to motor sport activity in the UK were revisited. This reflected new research that suggested the amount of unlicensed activity was higher than originally anticipated.

  This document also included additional analysis relating to the Personal Injury Discount Rate, a key assumption that underlies our work. In our original analysis the data underlying our model corresponded to a period of time when this rate was +2.5% p.a.[1]. However, when the work was carried out the rate had recently been revised to -0.75% p.a in England. In our original report we performed a sensitivity test to assess the potential impact of this change on our work. This memo carried out a further sensitivity test to assess the impact if the rate was +1.0% p.a. We further note that at the time of creating this combined report the rate has been changed to -0.25% p.a in England.

[1] Noting that the Personal Injury Discount Rate is defined as a margin above or below the Retail Prices Index

- External Peer review by GT (July 2019)

  DfT has arranged for all three phases of GAD's work to be peer reviewed by GT. This document summarises the results of GT's review, including their key conclusion and a list of the peer review observations ranked as 'high', 'medium' and 'low'.

- GAD's response to the external peer review (July 2019)

  This document sets out GAD's responses to the peer review points raised by GT. The response focuses on the 'high' ranked review points and includes further sensitivity testing to assess the potential effects of changes to the model.

These documents should be considered as components of a larger, aggregated report. As such, all of the documents should be considered in their entirety as individual sections, if considered in isolation, may be misleading and conclusions reached by review of some sections on their own may be incorrect. The documents taken in aggregate provide all the detail that is needed and have been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council ('FRC'). The FRC sets technical standards for actuarial work in the UK.