

Damages Seminar

**An Alternative to Lump Sum Awards
15th March 2000**

Chairman - Fraser Low

Agenda

- Chairman's opening remarks
- Introduction - Paul Kennedy
- Structured Settlements - Jonathan Yates
- International perspective - Jim Maher
- Income/Indemnity awards -Allan Martin
- The debate
- Closing remarks

Allan Martin

Damages Seminar

An Alternative to Lump Sum Awards

Introduction

Paul Kennedy

Introductory considerations

- Damages, severe injury
- Brain damage, spinal injury
- Numbers
- Amounts
- Needs
- Compensation, so far as possible, to put back in same position as before

Conventional approach

- Clean break
- Multipliers and multiplicands
- Adversarial: medical evidence
- Stable 4-5% pa: equity investment
- Implicit allowance for inflation

Initial reforms

- 1981 Index-linked gilts
- 1984 Ogden tables: population mortality
- Structured settlements, interim payments
- Civil Evidence Act 1995
- Damages Act 1996 - BUT
- 1996 Wells Court of Appeal judgment

December 1997 paper

- Discount rates: index-linked starting point
- Victims not ordinary investors
- Care and earnings inflation
- Need to project mortality
- Problems with lump sum awards
- Periodic payment alternatives

Wells, Thomas and Page

- House of Lords, July 1998
- 3% pa: index-linked yield
- Rounded 3 year average
- Ogden tables the starting point
- Retrospective

Post-Wells developments

- Worrall v Powergen: projected mortality
- Edwards: Lower index-linked yields
- Woolf reforms
- Conditional fees
- Human Rights Act
- LCD consultation

General insurer concerns

- Stable rating basis
- Retrospection
- Matching assets
- Finality and the balance sheet

Life insurer concerns

- Long term business
- Underwriting expertise
- Developing healthcare market
- Strict reserving requirements

Victim concerns

- Compensation for losses
- Security

Damages Seminar

An Alternative to Lump Sum Awards

Structured Settlements

Jonathan Yates

Lump Sum - Claimants: Pros

- lump sum may be too large
- no risk of defendant default
- provides flexibility and financial freedom
- covers past losses and immediate requirements
- suitable for small settlements

Lump Sum - Claimants: Cons

- lump sum may be too small
 - needs may be greater than expected
 - costs of care inflation may be higher than expected
 - plaintiff may live longer than expected
 - expected investment performance may fail to materialise
- relatives/carers may squander the lump sum
- plaintiff may fall back upon the State for care

Lump Sum: Defendants

Pros -

- liability is discharged in full
- suitable for small cases
- risk passes from defendant

Cons -

- lump sum may be too large

Structured Settlements

“ A **STRUCTURED SETTLEMENT** is the payment of money for a personal injury claim where at least part of the **SETTLEMENT** calls for future payment.

The payments may be scheduled for any length of time - even as long as the claimant's lifetime - and may consist of instalment payments and/or future lump sums.

Payments can be in fixed amounts or they can vary.

The schedule is **STRUCTURED** to meet the financial needs of the claimant. ”

National Structured Settlement Trade Association (USA)

Structured Settlements: Claimants - Pros

- adopt a 'needs-based' approach to restitution (*'bottom-up'* vs *'top-down'*)
- offer significant tax advantages
- prevent dissipation via mismanagement or adverse investment experience
- offer flexible solutions, eg young persons where money needed over very long period
- guaranteed index-linking ('RPI') of benefits
- provide lifetime guaranteed protection - risk passes to life assurance company
- annuity is fully secured against the insolvency of the life office under Policyholders Protection Act

Structured Settlements: Claimants - Cons

- require a ‘budget for life’
- inflexible - once in place
- RPI may not be a good proxy for increases in cost of care
- Index-Linked Gilts mistakenly believed to offer poor returns - *price of certainty*
- risk of loss of “capital” on very early death - *price of certainty*
- too much trouble

Structured Settlements: Defendants

Pros -

- liability is discharged in full
- offer significant tax advantages
- 'market pricing' of annuity should ensure lowest cost solution
- risk passes from defendant

Cons -

- income purchased may be too high
- 'market price' rather than negotiated settlement could result in higher costs of settlement
- too much trouble

Marketplace - **Intermediaries**

- IFAs - Independent Financial Advisers
- 'forensic' accountants
 - specialists in structured settlements
 - designing financial packages for plaintiffs
 - bringing defendants and plaintiffs together
 - satisfying the legal and Inland Revenue requirements
 - making it happen
 - undertake lobbying to gain wider acceptance, understanding and more favourable treatment:
 - law, politics, tax

Marketplace - **Insurers**

- few insurers active in market - rarely more than 5 at any one time
- various barriers to entry into market
 - lack of specialist underwriting experience
 - small size of market fails to provide ‘pooling’ of risks, possibly leading to an overly prudent approach to underwriting
- the market will need to grow if more participants are to be enticed into the market

Marketplace - **Intermediaries** - *remuneration*

Professional fees

- charges based on hourly rate
- ‘professional’ approach
- defendant pays costs regardless of whether a structured settlement is achieved

Commission

- ‘no win : no fee’
- remuneration may exceed a *reasonable* hourly rate for time spent
- uncertainty as to whether a structured settlement will be achieved encourages defendant to prefer this approach
- does plaintiff pay?

“ The conventional lump sum approach was, at its inception, not adopted as a result of sound ideological reasoning, but rather for purely expedient ends.

With the advent of computerisation and advancements in actuarial science, the Courts are now in a position to administer an alternative system. ”

JP Weir

Damages Seminar

An Alternative to Lump Sum Awards

**International Perspective
on Damages**

James M. Maher

International perspective

- Discuss provision for damages
- Motor and Workers Compensation systems in:
 - USA
 - Australia
 - Continental Europe
 - France
 - Germany
 - Belgium

USA Traditional Systems

- **Motor: Lump Sum Awards**
- **Workers Compensation (WC):**
 - 1) Indemnity: Annuity for wage replacement, plus various ancillary benefits
 - 2) Medical: Full coverage of hospital costs and continuing care
 - 3) Rehabilitation: Focus on return to work

US Traditional- WC, ctd.

- **Indemnity: not full wage replacement**
 - usually 2/3 basis (but tax free) subject to min and max, unindexed
 - tradeoffs: statutory no-fault system, no need to prove fault, encourage return to work
- **Medical: often done on managed care basis**
 - but Insurer incentivised to provide excellent care to facilitate return to work

US Traditional- WC, ctd.

- Rehabilitation- system works fairly well due to no-fault basis
- Paraplegic work accident victim-
chances of full time return to work:
 - 50% in Scandinavia
 - 30% in USA
 - 15% in UK

US Structured Settlements

- Introduced in 1960s, took off in 1970s
- Commonly used now in both motor and WC
- Usually based on both parties agreeing
- Approximately 50,000 structures per annum
- Framework very similar to UK (UK simplified and improved on US system)
- Done either via annuity or US treasury trust fund

US Structures, ctd.

■ Main reasons for use:

- 1) tax advantages: tax free (same as UK)
 - win/win situation, insurer and claimant usually notionally divide the savings
- 2) Risk of dissipation:
 - 25-30% of accident victims dissipate lump-sums within 2 months
 - 90% spend it all in 5 years (Source: California Practice Guide: Personal Injury, Rutter Group, Chapter 4)

US Structures, WC

■ Review

- Depending on jurisdictions, may be open to review if change in condition or mistake in fact
- In some jurisdictions, no review allowed.
- N.B. in motor cases, no review is allowed

■ Court approval

- Needed in most jurisdictions
- Not common law court, usually state WC board

Australia (NSW)

- Workers Compensation: similar system to USA traditional system
- Motor: Lump sum awards used exclusively
 - little to no use of structured settlements
 - structures allowed, but currently not tax-free
 - both parties must agree to structure
 - either party can apply for later review- insurers reluctant for this reason to structure

Australia (NSW), ctd.

- Lump sum awards found to be problematic:
 - Bass Study: 75% of claimants exhausted award within 6 years
 - 70% had continuing accident related medical costs unpredicted at settlement date
 - Neave & Howell Study: Only 32% named investment as major use of award in 1st year
 - 17% named a luxury item instead!

Australia (NSW) ctd.

■ Tax issue:

- 1997: NSW Motor Accident Authority (MAA) proposes adopting UK “structures” system
- Endorsed by NSW government, but not adopted by Federal Government (Treasury concerns re loss of taxation revenue)
- Coopers & Lybrand study- adopting “structures” would produce a gain to the Treasury rather than a loss (dissipation issue)

Australia- C&L study findings

- Government net liability for lump sum claimants:
 - At least \$225m p.a. for 6,000 lump sum claimants
 - Took into account taxation revenue from claimants returned to work
 - Social Security liability of \$500m incurred for these claimants
 - Adopting MAA proposal would halve the social security liability and eliminate overall net liability
- (authors: John Walsh, FIAA; Raewin Davies, FIAA)

Australia- tax issue, ctd.

- 1999: Federal Government announced taxation issue would be considered in 2000 budget
- Budget to be announced on 20 May 2000
- Could be implemented by 1 July 2000
- Recent study, Treasury would save between \$4-8m per annum even if 30-60 structures done each year

Continental Europe- Motor

- Annuities provided by general insurers, lumps sums common as well
 - France: indexed annuities common, indexation provision is borne by state
 - Belgium: annuities rare, done on indexed basis
 - mostly for minors, imposed by court
 - insurance industry not in favour of expansion, pool set up to equalise costs
 - Germany: unindexed annuities traditionally - now lump sums are common

Continental Europe, ctd.

- Most jurisdictions: judge has power to award annuity
 - i.e. agreement of both parties is not needed.
 - Non-motor damages: indexation basis can be set by judge and indexation is borne by general insurer
- In general, annuities for wage replacement are taxable,
 - otherwise tax free (e.g. nursing care)

Continental Europe - WCA

■ Belgium and Portugal: insurance systems

■ Belgian system - similar to US

- wage replacement on capped basis, indexed annuity (wages generally indexed in Belgium)
- medical costs covered (Social Security primary)
 - Belgian medical, generally coinsurance system
 - In case of workplace accident, WCA insurer picks up portion of costs that individual would have had.
- in contrast to US, medical not major portion of claim

Damages Seminar

An Alternative to Lump Sum Awards

The Future

Allan Martin

Lump Sum Settlements

- Accepted approach
- Discharges liability
- Flexibility and freedom
- Suitable for small settlements
- No risk of defendant default
- Transfers risk to claimant
- Money may run out

The Future

- Structured settlements
- Investment and mortality risk removed
- Tax break, clean break
- Security, RPI+2%, but
- Subject to negotiation
- Not widely used
- Compulsory consideration?

Income/Indemnity Award

- Definition - a new form of award
- Fundamental shift
- Multiplicand assessment, only
- Clean break - generally no
- Loss of earnings/pension
- Care costs
- Not small claims (under £200K)

Income Awards

- Fundamental shift
- Stop at the multiplicand
- Assess current monetary requirements
- Income award - £ pa + increases
- Without review = “structured settlement+”
- With review - no clean break, legislation and supervision and security issues

Indemnity Awards

- Amend multiplicand to “needs” per annum
- Care needs (6-10 NDNs)
- (+ Income needs - earnings and pension)
- Same fundamental shift
- With review - another fundamental shift
- Court framework
- Legislation, security, supervision

Indemnity Awards

- Existing indemnity awards
- NHS
- Provision of care (only)
- Reserving
- Security
- Rehabilitation

Income/Indemnity Awards

- Insurance policies
- General insurance
- Reassurance with life office?
- Security - insurers, others
- Special fund, government guarantee?
- Supervision
- Special class

Costs

- Lump sums
- Win or lose in court following offer
- Income award - capitalise income
- Review, no clean break, no winner
- Court or statutory framework

Summary

	Security	Legislation	Clean break
1 Structured Settlement	Yes	Exists	Yes

Summary

		Security	Legislation	Clean break
1	Structured Settlement	Yes	Exists	Yes
2	Compulsory Structured Settlement, RPI+2%	Yes	Court rules?	Yes

Summary

		Security	Legislation	Clean break
1	Structured Settlement	Yes	Exists	Yes
2	Compulsory Structured Settlement, RPI+2%	Yes	Court rules?	Yes
3	Income award without review	Yes, but framework required	Small step	Yes

Summary

		Security	Legislation	Clean break
1	Structured Settlement	Yes	Exists	Yes
2	Compulsory Structured Settlement, RPI+2%	Yes	Court rules?	Yes
3	Income award without review	Yes, but framework required	Small step	Yes
4	Income award with review	“	Required	No

Summary

		Security	Legislation	Clean break
1	Structured Settlement	Yes	Exists	Yes
2	Compulsory Structured Settlement, RPI+2%	Yes	Court rules?	Yes
3	Income award without review	Yes, but framework required	Small step	Yes
4	Income award with review	“	Required	No
5	Indemnity award (with review)	“	Required	No

Requirements

- Focus on needs and risks
- Social and political understanding
- No vested interests
- Legal reform
- Security and reserving framework
- Informed debate
- Catalyst - LCD consultation

The Motion

- The needs of victims and society would be better served by courts making income or benefit awards. This would be more effective than awarding lump sums.