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Structured Settlements

Few people would not be moved by hearing the words of Sydney grandmother Judie Stephens concerning her grandson Jackson, who was just three months old when a car crash left him brain injured, blind and quadriplegic.

Mrs Stephens daughter and her husband (Jackson's mother and father) were killed in the accident.

Mrs Stephens says
"Jackson is unlikely to ever be able to work and will need care for the rest of his life.
When I am dead, a structured settlement will absolutely guarantee that Jackson has quality care for the rest of his life."

She says "Our Government must act quickly to ensure that structured settlements are made available to protect people like Jackson."

Let me pay tribute to Judie's tireless efforts to reform the law to encourage structured settlements, and say to her that Labor has listened to her. I announce today Labor's interest in making periodic payments for accident victims tax free, as lump sums presently are.

Labor will now engage in a round of consultation with representatives of victims, the insurance industry, the legal profession and relevant State authorities with a view to finalising our position prior to the election campaign.

At present a person who permanently loses all, or a significant part of their earning capacity, and who requires extensive long term care due to the injuries they have suffered, may well be entitled, depending on the circumstances of the injury, to a large amount of compensation.

In Australia this is almost invariably taken in the form of a lump sum. The reason for this is essentially twofold. First, there is no doubt a “lump sum mentality,” partly due to the attractiveness of “finality”. Claimants like to receive a final payment which they can spend as they please, and defendant insurers also like to make a final payment so that they can close their files.

Secondly, there is the current uncertainty regarding the tax treatment in Australia of periodic compensation payments. If a claimant receives compensation as a lump sum, it is generally received tax free. But a claimant who receives compensation in the form of periodic annuity payments payable for an indefinite period, such as the claimant’s life, may be subject to income tax. While the Tax Office’s attitude to these periodic payments remains unclear, injury victims are not prepared to accept their compensation in the form of periodic payments and take the risk that they will be income taxed.

The problem of lump sums.

The object of personal injury compensation is, as best one can do this with money, to put the victim back in the position they would have been but for the accident. Lump sum compensation frequently fails to achieve this. Because a whole series of calculations are required about the victim’s life expectancy, inflation, investment returns, their capacity to return to work, the cost of injury related care and medical attention, lump sums frequently get it wrong.

Sometimes a victim dies shortly afterwards and their dependants receive a windfall gain. More frequently the lump sum compensation turns out to be inadequate and the victim ends up as a social security recipient. A Business

Review Weekly report suggested that 60% of recipients who receive lump sum payments have dissipated the amount within 5 years.

Sometimes lump sums run out because they are improperly managed. The anecdotal stories of this kind are dreadful. One recent Victorian case involved a woman who had spent her quadriplegic son's compensation settlement on poker machines.

An alternative proposal.

Acutely aware of these shortcomings, a number of victims' families, members of the legal profession and insurance companies have developed and have been campaigning for the alternative to lump sums - periodic payments.

This alternative is referred to as a "structured settlement" – a technique that enables those who are injured to receive all or part of their compensation in the form of a periodic payment, rather than wholly in the form of a lump sum. The essence of the structured settlement arrangement is as follows;-

- It doesn't completely exclude a lump sum; most structured settlements include an upfront lump sum component.
- It is optional rather than mandatory – that is it is only entered into with the agreement of both claimant and defendant,
- It usually refers to an out of court periodic payment settlement agreement between the parties, although it is quite possible for such an arrangement to be ordered by a court.
- It applies in the context of compensation for personal injuries, where the victim has an action for damages against a defendant, where the defendant is liable for damages and is insured in respect of that liability.
- It is most appropriate where the damages are large and include substantial future care and lost future earning capacity components.

Benefits of Structured Settlements.

There are obvious advantages for victims in having an annuity rather than a lump sum. The payment is not dependent on investment returns and continues right throughout the person's life. There are also advantages for defendant insurance companies. Based on overseas experience the introduction of Structured Settlements may result in savings to general insurers of the order of 8 to 15%. This is because the settlement sum which the defendant insurer has to pay to settle the case in a structured settlement is generally 8 to 15% less than the sum which would otherwise have to be paid out as a traditional lump sum.

Savings to Commonwealth and State Governments

Despite the fact that the advocates of structured settlements want the Commonwealth to provide that annuities will not be taxed as income, and therefore to forego revenue as a result, investigations into the impact of this change suggest that it will save money for both the Commonwealth and State Governments. The NSW Motor Accidents Authority 1998 report on structured settlements contains reasonably detailed financial modelling of the Structured Settlements proposal.

This analysis of their estimated over 5,000 claimants each year who receive a lump sum in excess of $100,000 in settlement for personal injury, is that these claimants cost the Commonwealth some $225m per annum.

This is made up of $540m in social security costs, and $94m in health and welfare costs, offset by taxation revenue of $408m leaving a net cost of $225m. Modelling of the structured settlement alternative reduces the social security cost to $324m, and the health and welfare cost to $14m, leaving a total of $338m. Although the taxation revenue is reduced from $408m to $332m, the net cost is $6m, a saving of $218m for the Commonwealth.

Another survey of potential costs and savings from structured settlements was carried out by consulting actuaries Cumpston Sarjeant in February this year. This report produces a much lower saving to Government from structured settlements, of between $1.7m and $3.4m. This is because it uses a much more conservative estimate of the number of people who would actually take up a structured settlements option.

Based on UK figures it suggests that in Australia there would be 30 to 60 structured settlements each year. Once again, however, it suggests that the foregone tax on present lump sums, of between $2.6m and $5.2m, would be more than outweighed by the social security savings of $2.0m to $4.1m and health and welfare savings of $2.3m to $4.5m respectively.

While the reports rest on a number of assumptions they are a reasonable basis for believing that such a measure would not be a cost to revenue. I have asked a number of Questions on Notice designed to elicit information about the Government's own assessment of this issue.

International Position.

The Common Law countries Britain, the United States and Canada have similar legal systems to our own. It is highly significant that each has moved in recent years to facilitate structured settlements.

In United States in 1982 the Internal Revenue code was amended to exclude from gross income any damages received "whether as a lump sum or periodic payments" on account of personal injuries or sickness Money paid out in structured settlement annuities has grown from under $1b US at this time to $5 1/4 billion by 1996.

In Canada Revenue Canada announced in 1979, and refined in 1981 and 1987, an advance ruling that periodic payments received by a claimant as part of a settlement agreement were tax free.

In United Kingdom, in 1984 Inland Revenue gave tax clearance to a hypothetical structured settlement case, and from 1990 structured settlement cases begin to be settled. The tax free status of structured settlement payments was confirmed by the Finance Act of 1995 and progressed by the Damages Act of 1996, which specifically authorises Courts awarding damages for personal injuries to make consent based orders for periodical payments.

The position in Australia

A recently formed group, the Structured Settlement Group (SSG) has as members the Australian Plaintiff Lawyers Association, Injuries Australia, Insurance Council of Australia, The Law Council of Australia, and United Medical Protection. This organisation has been heavily lobbying the Howard Government and a number of Government MPs have given their support to the Group's objectives.

Regrettably, however, the Government has failed to respond to their proposals, and I challenge the Government to either indicate clearly to Judie Stephens and to the rest of the country what its objections to this proposal are, or to adopt it.