



**EPS Settlements Group of Canada**

*The Structured Settlements Company™*

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CLAIMS EVALUATION,  
NEGOTIATION AND THE ROLE OF  
STRUCTURED SETTLEMENTS

# INTRODUCTION

Structured settlements or structured annuities have conventionally been thought of as instruments of investment only. And to this day, many still consider them as such. The usual practice is to employ an accountant, actuary or economist to calculate the present value of future damages, settle the case by reference to those calculations and obtain or concede (depending on which side of the bar you find yourself) the right to structure.

Increasingly, however, particularly in the first party, No Fault or Accident Benefits (“AB”) environment, structured settlement costs have supplanted the present value calculations of the aforementioned experts. The reason for this is quite simple. Structured settlement costs are:

1. produced free of charge;
2. produced with a scientific mortality rating; and
3. real in that the life insurance companies producing these are actually prepared to assume the liability for the payments related to these costs (which is not, of course, the case for the above-cited experts).

Add to this the fact that AB claims are conducted in terms of tax-free, periodic payments, and a structured settlement cost becomes the perfect means by which to calculate the present value of future streams of AB entitlement (i.e., an AB claim, paid on a periodic, tax-free basis, is *de facto* a structured settlement, subject to the contingency of disentanglement).

In the tort claims environment, the use of structured settlements as a present value calculator has been slower to take hold. The reasons for this are many, but include the presence of legislation in many jurisdictions that mandates future damages be calculated by way of a mathematical present value based on a prescribed discount rate.

That said, the movement to use structured settlement costs as a means of calculating the present value of future damages continues. Evidence of that in Ontario is section 116.1 of the *Courts of Justice Act*, which states:

Despite section 116, in a medical malpractice action where the court determines that the award for the future care costs of the plaintiff exceeds the prescribed amount, the court shall, on a motion by the plaintiff or a defendant that is liable to pay the plaintiff’s future care costs, order that the damages for the future care costs of the plaintiff be satisfied by way of periodic payments.

# TORT CLAIMS

Structured settlements produce tax-free income. Who derives the benefit of this is dependent on how a claim is evaluated and negotiated.

All tangential argument aside, the “rules” to this process are:

1. Future damages are to be calculated using a mathematical present value, with the underlying discount rate either mandated by legislation<sup>1</sup> or subject to negotiation.
2. The consent to a structured settlement is the prerogative of the casualty insurer;<sup>2</sup> that is, absent legislation (and a judiciary willing to exercise the authority to order a structured settlement), the casualty insurer has the right to say no to a structured settlement, thereby denying the claimant the tax benefit associated with it.

## ***Case Study***

John Smith was proceeding home, alone, through an intersection on a green light, when the vehicle he was operating was T-boned. John was hospitalized with a very serious head injury. The facts pertaining to John’s “Loss of Income” claim are as follows:

1. John is 45 years of age.
2. John suffered a moderate to severe traumatic brain injury, will never work again and was reasonably expected to work until age 65.
3. John was employed as a general factory worker and earned \$12.00 per hour over a 40-hour work week; that is, \$480.00 gross per week and \$393.04 net per week.

Note: Medical documentation has been submitted and a life impairment rating of +10 has been obtained.

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<sup>1</sup>In Ontario, the discount rate is mandated by Rule 53.09(1) of Rules of Civil Procedure under the *Courts of Justice Act*.

<sup>2</sup>This is so because in order for structured settlement income to be tax free in the hands of the claimant, a casualty insurer must purchase the structure, own or assign its ownership and make an irrevocable direction of all payments to the claimant.

	<b>Structured Settlement Investment</b>	<b>Tax-Free Weekly Income</b>
<b>“Top-Down” Calculation</b>	<b>\$491,682.05</b> (present value of claimant’s gross earnings to age 65 pursuant to the Ontario discount rate)	<b>\$560.18</b> (tax-free weekly income produced by investment of present value in a structure)
<b>“Mid-Range” Calculation</b>	<b>\$421,668.52</b> (structure cost to produce \$480.00 net per week to age 65)	<b>\$480.00</b> (claimant’s gross earnings per week, produced net-of-tax)
<b>“Ground-Up” Calculation</b>	<b>\$345,734.76</b> (structure cost to produce \$393.04 per week to age 65)	<b>\$393.04</b> (claimant’s net weekly earnings pre-accident)

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A “Top-Down” calculation amounts to the mathematical present value of the claimant’s full lump-sum loss invested in a structured settlement. In effect, by virtue of the amount of tax-free income this produces, the claimant is indemnified beyond his or her loss.

In the example above, the claimant earned \$480.00 gross per week prior to the accident. If the Ontario discount rate is applied, the present value of his future income loss equals \$491,682.05. If this amount is invested in a structured settlement, the claimant will receive a tax-free weekly income of \$560.18, well in excess of what he earned on either a net or gross basis prior to the accident.

A “Ground-Up” calculation is based on the claimant’s loss assessed by reference to the amount that needs to be invested in a structured settlement to replace what the claimant will lose on a periodic, net-of-tax basis. By virtue of this calculation, the claimant gets exactly what he or she has lost, on a net-of-tax basis, and the casualty insurer enjoys the full benefit of the tax savings through a significantly lower (relative to a present value calculation) loss payment.

In the above-cited example, the claimant’s pay, net-of-taxes, is \$393.04 per week. The cost of a structured settlement that would produce that amount of tax-free weekly income into the future is \$345,734.76. If the settlement were concluded for that amount, the claimant would receive less than what he or she would be awarded at trial and, as stated above, the casualty insurer would pay less.

The mid-range calculation is the range between the “Top-Down” and “Ground-Up” calculations, by which the tax savings of a structured settlement is shared between the claimant and the casualty insurer. The degree to which a “win-win” outcome is produced here is a matter of negotiation; that is, each side is likely to argue initially from their respective positions of strength:

1. The plaintiff will maintain (in this Ontario-based example) that future damages will be awarded at trial based on a present value calculation in accordance with the discount rate prescribed by Rule 53.09(1).
2. The defendant will respond with the argument that if a structured settlement is to be included, it will require the casualty insurer’s consent and that consent will not be given if the damages in question are to be calculated strictly pursuant to what may be awarded at trial.

An amount within the “Mid-Range” calculation is often what is arrived at by experienced practitioners. By reference to the above-cited example, if a structured settlement were to be purchased to produce \$480.00 per week, the claimant would derive benefit through the fact that this amount (which is his pre-accident, “gross” weekly income) is received tax-free. On the other hand, the cost to produce \$480.00 per week, tax-free *via* a structured settlement, amounts to \$421,668.52, an amount significantly less than the mathematical present value the defendant casualty insurer would be called upon to pay at trial.

## ACCIDENT BENEFITS CLAIMS

AB claims are made and paid, regardless of fault, on a first party, contractual basis. The contract for AB does not stipulate a need to pay any claim into the future. This is very different from tort claims, for which there will be a requirement, at some point, to settle, speculatively, into the future.

In short, in the AB environment, if the casualty insurer discharges its duties and obligations in accordance with the terms and conditions of the contract to date, it is compliant. Disputes may arise over whether the casualty insurer has, indeed, complied with the terms and conditions of the contract, but not over the present value of whatever may be owed in benefits in future.

That said, so as to bring final resolution to claims for AB, both casualty insurers and claimants often engage voluntarily in settlement negotiations, and structured settlement costs are now, for the reasons stated above, the generally accepted means of evaluation (and settlement).

## ***Disposition Options***

The disposition options for AB claims are as follows:

1. Pay the benefits on an incurred/incremental basis, as prescribed by the policy contract.
2. Obtain a market-based present value (i.e., a structured settlement cost) in reference to the contractual obligation to pay future benefits and negotiate a cash settlement on the basis of this, usually with a significant portion of the cash settlement invested in a structured settlement (with or without the casualty insurer named as the secondary payee or beneficiary).
3. Unilaterally purchase a structured settlement to offload the contractual obligation to pay future benefits, in whole or in part, with the casualty insurer named as the secondary payee/beneficiary.

### ***Option 1***

This is the primary, legislated obligation; that is, the casualty insurer need do no more than assess coverage and make payment of claims on an incurred, incremental basis as prescribed by the contract.

### ***Option 2***

The second, cash-out option is attractive in that a successful settlement will bring closure to the claim(s) in question.

In order to negotiate a settlement hereunder, the steps are usually as follows:

- a. Quantify the present value of future entitlements by employing structured settlement costs (in reference to specific assumptions).
- b. Engage in negotiation over the competing assumptions and related valuations, taking account of the fact that there is nothing compelling a casualty insurer to settle an AB claim for cash (i.e., the casualty insurer is obliged only to administer “Option 1” and therefore will expect a discount off whatever valuation is ultimately employed in settlement).
- c. Settle the claim, with a significant portion of the cash-out invested in a structured settlement (so as to protect all concerned from the premature dissipation of a first party, contractual obligation).
- d. Negotiate who is to be named as the secondary payee/beneficiary, should that be wanted or required (i.e., if wanted or required, it will be the prerogative of either the casualty insurer or someone named by the claimant).<sup>3</sup>

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<sup>3</sup>In this context, the casualty insurer will argue from a relative position of strength in that: 1. nothing compels a cash settlement of an AB claim; and 2. were the claimant to die during the normal course of administering benefits pursuant to “Option 1,” all claim reserve amounts posted by the casualty insurer would revert to it. In effect, a common requirement of a cash settlement will be that a significant portion of the settlement go into a structured settlement, with the casualty insurer named as the secondary payee or, in other words, the holder of a reversionary interest.

### **Option 3**

*In lieu* of making payment directly, a casualty insurer may wish to discharge its first party, contractual obligation through the direct purchase of a structured settlement. This may be done unilaterally, so long as what is being replaced by the structured settlement is beyond dispute (e.g., the payment of a maximum monthly benefit).

The principal advantage of this option to the casualty insurer is the elimination of the administrative costs associated with an open file. Furthermore, the purchase of a structured settlement may result in a reserve savings, in that a structure cost may reflect an impaired life expectancy rating, whereas reserves may not.

The primary advantage of this option to the claimant is that it usually eliminates the contingency of disentanglement and the involvement of the casualty insurer in the claimant's day-to-day life. The claimant may also derive a benefit insofar as life insurance companies are capable of conveying payments directly *via* electronic funds transfer, whereas casualty insurers are generally not.

This option usually involves a guarantee to secondary payee/beneficiary or reversionary interest, invariably with the casualty insurer named.

#### ***Guarantee to Secondary Payee/Reversionary Interest***

If opted for, a guarantee to secondary payee/beneficiary or reversionary interest will usually form part of the structured settlement contract under options "2" and "3." A guarantee to a secondary payee/beneficiary or reversionary interest is a guarantee term that ensures that the secondary payee receives, upon the death of the claimant, the remaining payments (perhaps on a commuted basis if the secondary payee named is the casualty insurer) within the term of the guarantee to secondary payee/beneficiary or reversionary interest.

## **CONCLUSION**

For reasons stated above, structured settlement costs are now the convention by which the present value of the future entitlement to AB claims is calculated in the context of a cash settlement. Increasingly, structured settlement costs are also being used in the tort claims environment. The degree to which structured settlement costs are accepted as the "present value calculator" for future heads of damages in tort is ultimately a matter of education and advocacy skill.



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