

# Discount rates and the GFC – a double whammy

By Clara Davies



A well-established common law principle is the application of discounts to future losses or expenditure to take into account two factors: the interest that can be earned from investments, and the contingency that any allowance made for such losses might never, in fact, be spent.

In December 1981, the High Court of Australia decided the case of *Todorovic v Waller*.<sup>1</sup> The case was an authority on the actual 'discount rate' to be applied by Australian courts in assessing lump sum damages awards in personal injury litigation.

In *Todorovic*, the Court recognised that the choice of a discount rate was extremely important, for a difference of even 1 per cent could produce substantial differences in lump-sum damages awards. At the time, Stephen J noted that 'a loss of earnings of \$250 per week for 30 years produced a present lump sum of \$391,350 if a discount rate of 0 per cent was applied; \$259,500 if 3 per cent was applied and \$205,500 if 5 per cent was applied.'<sup>2</sup> The Court ended up agreeing on a rate of 3 per cent to be applied nationally.

Despite agreeing on the rate, it was observed that the calculations required in the assessment of damages were 'far removed from all reality' and, further, that 'any decisions as to the way in which the law should be reformed depends on views as to social policy which can be formed only by the legislature'.<sup>3</sup>

Since *Todorovic*, every state and territory throughout Australia (except the ACT) has, through legislative reform, increased discount rates. The

average discount rate across the nation is between 5 per cent and 6 per cent, with some jurisdictions applying rates as high as 7 per cent. Using Stephen J's example of a \$250 net weekly loss occurring over 30 years, this could mean a reduction of the injured accident victim's future losses of up to \$74,650 (6 per cent).

The first legislative amendment altering the applicable discount rate was in July 1984 in NSW<sup>4</sup> and, since then, legislatures across the nation have progressively handed massive windfalls to insurers by increasing discount rates, and thereby reducing damages awards.

Add to this the GFC – the global financial crisis – and suddenly injured accident victims are hit with a 'double whammy' of higher discount rates and lower cash interest rates. The future losses of injured accident victims are presently being discounted by percentages that are impossible to recoup, given the current economic climate.

Given the current volatility of the markets, there is no question that for the average 'mum and dad' investor, which is the profile of the majority of our clients, the banks offer the safest investment options. In April 2009, the Reserve Bank of Australia lowered the official cash rate to 3 per cent. Currently, the best rate an investor can secure from the financial institutions, is somewhere between 4.5 per cent and 5 per cent for a fixed-term deposit of between three and five years. Unfortunately, the majority of injured accident victims cannot afford to lock their damages awards away for such extended periods of time. So the losses for the injured accident victim

continue to mount, even after receiving their damages.

At the time of *Todorovic*, the official cash interest rate was 12.5 per cent, and the High Court considered 3 per cent to be the appropriate discount rate. However, although the average official cash interest rate has been 9 per cent or less since October 1996, with the exception of several months in early 2008, the discount rates have climbed to approximately 6 per cent. Obviously a disparity has developed that is very disadvantageous to injured accident victims.

The GFC has driven interest rates to their lowest levels in 50 years, effectively exacerbating this inequitable situation. Now, more than ever, the argument for a comprehensive review of discount rates is compelling. At the very least, we should arguably return to the discount rate of 3 per cent adopted by the High Court of Australia in December 1981. ■

**Notes:** 1 (1981) 56 ALJR 59. 2 *Todorovic v Waller* (1981) 56 ALJR 59, at p69, per Stephen J. 3 (1981) 56 ALJR 59, at p66. 4 *Motor Vehicles (Third Party Insurance) Act 1942*, s35B, applies to personal injuries and deaths payable out of the Transport Accidents Compensation Fund from 1 July 1984.

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