Seeing Beyond Risk Canadian Institute of Actuaries Institut canadien des actuaires Voir au-delà du risque

March 7, 2014

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Dear Mr. Kraemer,

This letter is further to the pre-hearing conference on January 8, 2014, and your invitation to the Canadian Institute of Actuaries (CIA) to submit additional comments concerning the discount rates prescribed by Regulation 352/81 under the Law and Equity Act.

This document supplements our initial submission to you dated April 23, 2013, and should be read in conjunction with that submission.

As you know, the CIA holds the duty of the actuarial profession to the public above the needs of the profession and its individual members. We are required by our professional Standards of Practice, and also by the rules of court that govern expert witnesses in many jurisdictions, to act in an independent, non-partisan manner when offering opinions in civil litigation matters.

In the context of the current review, we wish to make meaningful and timely contributions to public policy and provide relevant research in support of government decisions.

The key recommendations of our initial submission were as follows:

a. Introduce a formula-based approach and an automatic "periodic reset" of the mandated discount rates;
b. Adopt a stepped rate format to replace the current level rate format; and
c. Carefully consider the structure and number of mandated rates—for example, is it best to mandate "real" discount rates as at present, or instead mandate a nominal discount rate and a separate inflation assumption? Is it best to mandate different discount rates for different heads of damage as at present, or instead mandate the same discount rate for all heads of damage?

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The purpose of the first two of the CIA recommendations is to permit the mandated discount rates to reflect the current economic environment at any point in time, while anticipating an eventual return to historical norms. We note that three other organizations (the Canadian Bar Association, the Law Society of British Columbia, and Turnbull and Associates) included recommendations substantially similar to ours in their submissions. Also, we observe that adoption of a fixed mandated discount rate that reflects the perceived current economic environment is conceptually equivalent to an assumption that the current economic environment will continue indefinitely into the future without change. As we noted in our first submission, the impact of BC's current regime is adverse for plaintiffs at present, but also potentially for defendants at some future date. If a significantly lower level discount rate is adopted without an automatic reset mechanism, then the result may be the opposite—mandated discount rates that are adverse for defendants.

The purpose of our third recommendation is to invite you to consider alternative approaches to the mandating of discount rates. For example, by mandating a nominal discount rate and a separate inflation assumption, you could ensure that both indexed losses and non-indexed losses (for example, disability benefits, some pension benefits, income tax gross-ups) would be valued using consistent economic assumptions.

In our initial submission, we also attempted to highlight the importance of considering the objectives that underlie the mandated discount rates in British Columbia *before* making a decision on changes to the current regime. For example:

- Is the primary goal to restore the plaintiff to their pre-incident financial situation to the greatest extent possible, minimizing the probability of under-compensation or over-compensation (thus resulting in a resolution that might be considered fair and equitable)? We understand that this is the traditionally accepted objective. If this remains the goal in British Columbia, then an unbiased estimate derived from a technical actuarial/economic analysis will be the preferred result. This would almost certainly include an automatic reset mechanism and a stepped rate structure. It should also be noted that "fairness" may be defined differently by different stakeholders. Different assumptions concerning the appropriate risk/reward balance (investment strategy, asset mix, reinvestment, and duration) will yield different results in terms of an unbiased estimate. The complexity of this issue is apparent in the diversity of recommendations before you at present.
- If the answer to the above is no, then is the primary goal either the protection of the interests of possibly financially unsophisticated plaintiffs/victims or the control of insurance claim costs? Such public policy considerations may or may not be relevant in your review. If they are relevant, mandated discount rates that differ from the theoretical unbiased estimate are needed to achieve one of these goals.
- To what extent, if any, should the discount rates recognize potential future "productivity" effects?
- Should the discount rates include or exclude a margin to provide for investment management costs?

The focus of this second submission is to assist the Chief Justice in his review by illustrating the financial impact of the specific recommendations that were made by each of the other organizations. Any change to the current mandated discount rates will result in a financial benefit to either plaintiffs or defendants when compared to the status quo. Appendices A and B are intended to assist you in understanding the impact of the various recommendations under consideration.

Appendix C is an updated version of appendix B from our initial submission. We have added a valuation example based on the Ontario mandated discount rates for 2014 trials in order to illustrate the effect of an automatic reset mechanism. As you know, Ontario is currently the only Canadian jurisdiction with mandated discount rates determined by formula and with an annual automatic reset mechanism. It is also the only jurisdiction to have adopted a tiered rate structure.

Thank you for taking the time to review our second submission. If you have any questions, please do not hesitate to contact Chris Fievoli, the CIA's resident actuary, at 613-656-1927 or chris.fievoli@cia-ica.ca.

We look forward to the hearing on April 9. Jay Jeffery, an experienced actuary who is Vice-chair of the CIA's Committee on Actuarial Evidence and also a member of the independent Actuarial Standards Board, will present on behalf of the Institute.

Before or after the hearing, we would be pleased to assist further in the review process by answering any specific questions that arise during your analysis of the various recommendations under consideration.

Yours truly,

Jacques Lafrance, FCIA
President

APPENDIX A

Illustration of the Effect of Various Possible Mandated Discount Rates – Loss of Earnings

Present value of a loss of $50,000 annually until age 65, to a male, mortality decrement only (Statistics Canada 2007–2009 Life Table)

	Discount Rate	Valuation age 12 Commencement age 25	Percentage of Current	Valuation age 40 Commencement age 40	Percentage of Current
Current Section 56(2)(b)	2.5%	$891,000	100%	$902,000	100%
Macauley recommendation	1.5%	$1,197,000	134%	$1,007,000	112%
Canadian Bar Association, British Columbia Branch Automobile Insurance Committee (CBA)	0.02%[1]	$1,905,000	214%	$1,199,000	133%
Canadian Medical Protective Association (CMPA)	2.5%	$891,000	100%	$902,000	100%
Insurance Bureau of Canada (IBC)	2.5%	$891,000	100%	$902,000	100%
Insurance Corporation of British Columbia (ICBC)	3.0%	$774,000	87%	$856,000	95%
Law Society of British Columbia	1.5%	$1,197,000	134%	$1,007,000	112%
Trial Lawyers Association of British Columbia (TLABC)	0.0%, to 1.0% 0.0%	$1,917,000 to $1,395,000 $1,917,000	215% 157% 215%	$1,202,000 to $1,067,000 $1,202,000	133% 118% 133%
Turnbull and Company	0.0% for 15 years, then 2.0% thereafter	$1,386,000	156%	$1,160,000	129%

[1] For losses that pertain to “future incomes and labour-intensive costs”.

APPENDIX B

Illustration of the Effect of Various Possible Mandated Discount Rates – Other Damages, including Future Care Costs

Present value of a loss of $20,000 annually for life, to a male, mortality decrement only (Statistics Canada 2007–2009 Life Table)

	Discount Rate	Valuation age 12 Commencement age 12	Percentage of Current	Valuation age 40 Commencement age 40	Percentage of Current
Current Section 56(2)(a)	3.5%	$514,000	100%	$421,000	100%
Macauley recommendation	2.0%	$731,000	142%	$541,000	129%
Canadian Bar Association, British Columbia Branch Automobile Insurance Committee (CBA)	0.52%[2]	$1,127,000	219%	$720,000	171%
Canadian Medical Protective Association (CMPA)	3.5%	$514,000	100%	$421,000	100%
Insurance Bureau of Canada (IBC)	3.5%	$514,000	100%	$421,000	100%
Insurance Corporation of British Columbia (ICBC)	3.5%	$514,000	100%	$421,000	100%
Law Society of British Columbia	2.0%	$731,000	142%	$541,000	129%
Trial Lawyers Association of British Columbia (TLABC)	1.0% to 2.0% 1.0%	$969,000 to $731,000 $969,000	189% 142% 189%	$653,000 to $541,000 $653,000	155% 129% 155%
Turnbull and Company	0.5% for 15 years, then 2.5% thereafter	$818,000	159%	$619,000	147%

[2] For losses that pertain to "future costs that are not labour-intensive".

APPENDIX C (updated version of appendix B in the initial CIA submission)

Illustration of the Effect of Mandated Discount Rates in Different Jurisdictions

Present value of a loss of $50,000 annually to age 65 to a male, age 40 at valuation, mortality decrement only (Statistics Canada 2007–2009 Life Table)

Province	Mandated Rates as of 2014	Present Value
Alberta	No mandated rate	-
British Columbia	Loss of earnings: 2.50% Future Care/Other Damages: 3.50%	LOE: $902,000 FC: $813,000
Manitoba	3.00%	$856,000
New Brunswick	2.50%	$902,000
Newfoundland and Labrador	No mandated rate	-
Nova Scotia	Non-MVA: 2.50% MVA: 3.50% (Reg 4(1)) MVA: 0.37% (Reg 4(2) for 2012)	Non-MVA: $902,000 MVA(1): $813,000 MVA(2): $1,149,000
Northwest Territories	2.50%	$902,000
Nunavut	2.50%	$902,000
Ontario (2013 trials)	-0.50% for 15 years, 2.50% thereafter	$1,210,000
Ontario (2014 trials)	0.30% for 15 years, 2.50% thereafter	$1,115,000
Prince Edward Island	2.50%	$902,000
Québec	Loss of earnings: 2.00% Future Care (Goods): 3.25% Future Care (Services): 2.00%	LOE: $953,000 FC(G):$834,000 FC(S): $953,000
Saskatchewan	3.00%	$856,000