Focus PERSONAL INJURY

The trouble with prescribed discount rates

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The disconnect between prescribed discount rates and achievable yields has become a significant concern to plaintiff lawyers and independent economic loss experts over the past few years.

You don't need an actuary to tell you that interest rates are at historical lows. Readers lucky enough to have some savings to invest may have investigated guaranteed investment certificates recently. With yields hovering slightly over two per cent (which just happens to be the approximate rate of inflation), that's a zero per cent real rate of return. Not so appealing. In April, the yield on long-term non-indexed Government of Canada bonds was 2.19 per cent — also not appealing. That same month, the yield on Government of Canada real return (indexed to inflation) bonds was only 0.38 per cent.

For a number of years, personal injury plaintiffs have been faced with a similar investment quandary. Outside of Ontario, the prescribed "net" discount rate — also referred to as the "after inflation" or "real" discount rate — ranged until recently from a low of two per cent (in Quebec, for future lost earnings and care services) to a high of 3.5 per cent (in Nova Scotia, if the injury or death was the result of a motor vehicle accident).

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> …[L]awyers should be aware of inter-jurisdictional variations in prescribed discount rates.
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Eight provinces and two territories have prescribed discount rates for the determination of future pecuniary damages in civil litigation. Three provinces (British Columbia, Nova Scotia, Quebec) have prescribed rates that vary either by head of damage or by cause of injury. When law makers established the various provincial and territorial prescribed discount rates in the 1980s and 1990s, interest rates and real rates of return were higher and the assumed yields were achievable without the plaintiff taking on undue investment risk. In today's economic environment, investing in a portfolio of high-quality corporate and government bonds will not generate the returns that are required to replicate the stream of lost earnings and/or to provide for future care costs.

The current low interest-rate environment and certain province-specific issues have led four provinces to initiate reviews of their prescribed net discount rates in recent years.

Ontario was first out of the gate, implementing changes in 2013. In 1999, it had adopted a formula-based, annual reset approach under which the net discount rate for the first 15 years after the valuation date is linked to the current economic environment. The formula assumes an eventual return to historic norms, and so the net discount rate beginning 15 years after the valuation date is fixed at 2.5 per cent. The changes implemented in Ontario in 2013 were relatively minor. They included a reduction to the adjustment factor and introduction of a minimum (floor) discount rate of zero per cent for the first 15 years. These changes resulted in an increase to the prescribed discount rates when compared to the pre-2013 formula. Despite this, Ontario's prescribed discount rates remain the lowest in Canada.

British Columbia followed, early in 2014, with a significant decrease to its prescribed net discount rates. For most plaintiffs, B.C. now has the second lowest prescribed discount rates in Canada.

Later in 2014, New Brunswick changed its rule. The previous prescribed, presumably required, net discount rate of 2.5 per cent is now just the "default" rate. Parties to litigation are permitted to lead evidence in support of a net discount rate that is different from the default rate.

Nova Scotia has a prescribed net discount rate of 3.5 per cent for pecuniary damages arising from a motor vehicle accident (otherwise, the net discount rate is fixed at 2.5 per cent). The MVA discount rate is currently under review. Changes may occur within the next few months.

What does this mean for a plaintiff? If a 40-year-old male is injured in northern Ontario and has a lifetime need for $20,000 per year of future care costs (increasing with inflation over time), the resultant award would be $639,000 (using the Ontario prescribed discount rates for 2015 trial dates and the most recent Statistics Canada mortality table). That same person, if the accident occurred just over the border in Manitoba, would be entitled to an award of only $460,000. In B.C., this injured party would have been entitled to $425,000 prior to the 2014 rule change but is now entitled to $547,000.

Plaintiff lawyers should understand the possible disconnect between the prescribed net discount rate in their jurisdiction and the returns that their client may reasonably expect to earn in the near and mid-term future. In addition, lawyers should be aware of inter-jurisdictional variations in prescribed discount rates. In certain situations, it may be reasonable to consider (after discussions with your economic loss expert), arguments for a discount rate that differs from the regular prescribed net discount rate. Defendant lawyers should be prepared to receive and counter such arguments with their own qualified expert.

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