DISCOUNT RATE REDUCTION (MISCELLANEOUS ACTS AMENDMENT) BILL 2017

First Reading

Bill introduced on motion by Mr Clayton Barr, read a first time and printed.

Second Reading

Mr CLAYTON BARR (Cessnock) (10:43): I move:

That this bill be read a second time.

The purpose of the Discount Rate (Miscellaneous Acts Amendment) Bill 2017 is to amend the Civil Liability Act 2001, the Motor Accidents Compensation Act 1999 and the Worker's Compensation Act 1987 to reduce the discount rate of an award of damages for future economic loss from 5 per cent to 3 per cent. I will provide context for the bill: When a person is injured under either of the three Acts listed—civil liability, motor accident or workers compensation—their recovery from injury may leave them with a legacy condition that is deemed to have an impact on their future ability to earn a living in the workplace. That does not necessarily mean that they cannot return to work, but in returning to work, or not, there will be limits as to what they can do, how hard they can work and the earnings that they might realise.

The injured person enters into negotiations with the respective insurer or other responsible body. In many instances, through such negotiations, an amount is agreed to, all parties sign off and the matter is effectively finalised without ever going to court. However, in some instances the damages and the impact on future earnings cannot be agreed. In these instances the matter will proceed to court. At court a ruling is given. When an amount is awarded there are a number of factors applied in determining the amount given. This process is incredibly complex and while every effort has been made to make it objective and mathematical there is an element of subjectivity. It is important to note that in awarding an amount there is no single simple formula. I do not envy the judges responsible for this calculation.

Once an amount is determined factors such as the age of the victim, the working years ahead of the victim prior to retirement and statistical data on the likelihood of survival until retirement age and other elements are applied along with a discount rate. What is a discount rate and how does it work? Consider a case where the judgement has been made that a future loss of earnings for 45-year-old victim would be $100,000. The retirement age is 65. The judge has determined that over the next 20 years the victim, due to their injury, will likely earn $100,000 less than if they had not suffered the injury at all. If the judge were to allot the entire $100,000 up front and the person invested the money as instructed to do they would end up with an amount far more than the judgement of $100,000. Twenty years of investment with compound interest could turn that $100,000 into $130,000 or $140,000.

To avoid this the judgement requires the discount rate to be applied. The discount rate is applied such that if the person invested the money at a given interest rate over the 20 years they have left to work then the end result will be $100,000. Currently in the three Acts listed above the discount rate used is 5 per cent. The judge has no option but to use the 5 per cent discount rate. Therefore, the $100,000 award must be reduced. Based on a 5 per cent annual interest rate the victim would be awarded $42,000, told to invest the money at 5 per cent and if they do this over the next 20 years of their working life they will realise $100,000 as awarded at judgement. Can you spot the problem? The problem is that no-one anywhere in this country, or globally, can realise a 5 per cent interest rate in today's market.

No-one has been able to get 5 per cent since 2010, since the global financial crisis. The 10-year government bond rate today, as we debate, is set at just 2.61 per cent. The experts have determined that no-one will get anywhere near 5 per cent interest in the foreseeable future.

From the outset, we need to be clear and establish that a discount rate of 5 per cent is entirely inappropriate in today's terms. Unfortunately, for an injured person who will not make a full recovery and who has been awarded a lump sum at any time in the past seven years the situation is irreversible. Those people will never see anything close to the amount that the judgment awarded them. Those who know anything about compound interest or financial growth or graphs and charts will know that if one path is set at 5 per cent and a second path is set at 2.61 per cent then from day one there is a gap. As the lines advance across the chart, over the years the gap between the two gets larger. The gap amount can never be recovered. The lines will not catch up. The gap can never be reduced. In sporting terms, imagine a cricket match where one team bats for 20 overs at a run rate of five and another team bats for 20 overs at a run rate of 2.61. After the 20 overs, one team has 100 runs and the other team has just 52. The gap is 48. Imagine if that cricket match went on for 40 overs instead of 20. The gap grows and grows. After 40 overs the gap is 96.

The significance of this second example is that it highlights an important point about how the discount rate applies in the real world and the inadequacy of it. The longer a person has left to work, the more disadvantaged they will be by an unachievable 5 per cent discount rate. A person who receives an awarded lump sum judgement payment at 20 years of age, who still has 45 years left to work, will be far more disadvantaged and out of pocket than a 60-year-old person who might receive the same judgement but who has only five years left to work. In the five years, the gap between 5 per cent and 2.61 per cent, while still negative, is quite small. Over 45 years, the gap between 5 per cent and 2.61 per cent is incredibly large.

The same logic applies to a person who is far more significantly injured than a person with a mild injury. It is not hard to foretell that, in very broad and general terms, if one person loses a finger in an accident and another person loses a leg, the loss of the finger would probably be judged as minor in comparison to the loss of the leg. The lump sum awarded for the leg is likely to be much larger. It will be the leg injury, the larger lump sum, with a discount rate of 5 per cent applied to it, that will lose out significantly. It will be much further away from the sum awarded in the judgment and the person will be much more out of pocket. By comparison, the judgement for the finger is likely to be modest. As time progresses, the gap between the discount rate of 5 per cent and the reality of 2.61 per cent will still be negative and the person will still be out of pocket, but the gap will be much smaller. I acknowledge that a lost finger for a concert pianist, hairdresser or mechanic would be much more significant than a lost finger for a school teacher or a bus driver. Similarly, a lost leg would be more significant for particular occupations. Hence the need to deal with injuries on a case-by-case basis rather than by using an arbitrary medical scale—but that is a conversation for another day.

I return to the discount rate: where it is currently set at and where it should be set. I offer a number of significant points. The discount rate was established in the three Acts at various times over the past 30 years. Various methods, justifications and explanations have been used. To be frank, the 5 per cent rate has been neither here nor there for the past 30 years because interest rates have been well above 5 per cent. If someone wanted to lodge an argument that injured people received well above the judgement trajectory during the 30 years prior to 2010 then I would be unable to lodge much of an argument against that. Those people who were injured and had shorter periods to work prior to retirement possibly did well. Those who were injured and had a longer period to work may have experienced some good times during the 1980s, 1990s or 2000s, well above the 5 per cent, but recently their investment trajectory will have plummeted. No doubt they will be averaging something closer to the original judgment amount. Life cannot be changed for those people. It cannot be changed for those people injured in the 1980s, 1990s or 2000s, and it cannot be changed, sadly, for the people injured since the global financial crisis and before this bill was introduced. Their destiny has been set.

Today, in this place, we need to address tomorrow—the coming years—and the already injured or soon to be injured who are or will be in the system. We have to offer them a fair and reasonable future that will, in financial terms, allow them to realise an amount that is closer to the amount that was awarded in the judgment. We can do that by changing the discount rate from 5 per cent to 3 per cent. Why 3 per cent? The discount rate is an intellectual concept best examined by mathematicians and actuaries. Setting the rate is part science and part art. People far more eminent than me have set to this task, and they have suggested the 3 per cent rate. I refer now to some examples.

In Australia in 1981 the discount rate was addressed in the High Court in *TodorovicvWaller*. That judgment determined that, based on material available at the time, the discount rate should be set at 3 per cent. At the time of that judgment, the 10-year government bond rate was more than 12 per cent and interest rates were at 14 per cent. As I understand it, the 3 per cent rate at the time was reflective of long-term averages, had a built-in margin for error in terms of wages and growth, and accounted for the potential for a change in workplace. So the rate was set at 3 per cent, which, by any measure, was modest.

In 2002 the States of Australia, along with the Federal Government, invested in a review of the law of negligence. We need to understand that the bill that I have introduced today has little to do with negligence but, through whatever form or context, the theory surrounding the discount rate is the same. The review was undertaken by Mr David Ipp, Professor Peter Cane, Associate Professor Don Sheldon and Mr Ian Macintosh on behalf of Senator the Hon. Helen Coonan, then Federal Minister for Revenue and Assistant Treasurer. They are all big hitters, far more esteemed and qualified to consider discount rates than I am. The final report dealt with the issue of discount rate on pages 208 through to 211. The report made the following recommendation:

> The discount rate used in calculating damages awards for future economic loss in cases of personal injury and death is 3 per cent.

That was a recommendation of the report by Ipp and others, in 2002. At the time of the report, the 10-year government bond rate was 6 per cent, and it had averaged close to 10 per cent for the 20 years prior to the report. At the time, Australia was doing well economically. Construction rates were high and the mining boom was just beginning. At that time, in that context, 3 per cent was a very conservative finding. It is worth noting that, in making the finding, the report referred directly to the information that had been provided to the panel by the Australian Government Actuary—an agency staffed by people who spend their lives working in this field. On page 211 the report said:

> … the Panel has been informed by the Australian Government Actuary that, in his view, at present, a realistic after-tax discount rate might be in the order of 2 to 4 per cent …
>
> This suggests to the Panel that 3 per cent remains a reasonable rate … We therefore recommend a nationally uniform discount rate of 3 per cent.

It goes on further to say:

> Given the complexity and technical nature of the task of setting an appropriate discount rate, the Panel's opinion is that it should be given to an appropriate regulatory body.

This is probably the most significant report in the past two decades dealing with the discount rate. The panel had full access under ministerial authority to all the nation's best actuarial advisers, and they arrived at 3 per cent. Why is it 3 per cent? Clearly, it is not a figure that I have just plucked out of the air; members should not suggest in debate in this Chamber that it is some mystical figure that I made up. In fact, if I were to make up a figure using basic, sound logic, with the 10-year government bond rate currently set at just 2.61 per cent, I might suggest a discount rate of 2.5 per cent. But I am not doing that; I am not just taking a stab in the dark but I am deferring to the experts and allowing them to set the number.

I refer briefly to a summary of significant facts with regard to the discount rate. As I have said, the Australian actuary recommended in 2002 that it should be between 2 per cent and 4 per cent. David Ipp and company landed on the middle ground of 3 per cent in their final report. Twenty-one years earlier the High Court set a rate of 3 per cent. An inquiry into personal compensation also proposed a rate of 3 per cent. In the United Kingdom the rate is currently set at 2.5 per cent and in New South Wales the Lifetime Care and Support Scheme, although slightly different but in many ways the same, is currently set at 2 per cent. There is a plethora of other places and spaces where 3 per cent seems to be the obvious and applied number.

I want to pre-empt an argument that will undoubtedly be thrown back at me in the course of debate on this bill—it will probably be the Government's only argument. It is that lowering the discount rate will drive up the price of insurance. On this singular, very limited position Government members are correct. In fact, I have spent the past 12 months seeking guidance from various insurance companies as to the quantum and size of the potential rise. Interestingly, the insurance companies found that task incredibly difficult and it took them quite some time and effort, and required significant insight on the part of their actuaries. That tells us something about the complexity of this matter—as I said earlier, it is part science and part art.

The insurance companies have advised me of increases that range quite enormously, from a 3 per cent to a 9 per cent increase and everything in between. All those figures have been offered with various limitations on their accuracy. I pre-warn Government members that if they offer in this Chamber a specific figure with regard to an insurance premium increase they will highlight their ignorance, not their intelligence. It is worth noting the positions of Ipp and company on insurance premiums This is very important in pre-empting the logic that will be applied by Government members. On page 25 of the report the terms of reference for the panel include:

> 1.2 This was the second Ministerial Meeting held to discuss public concerns about the cost and availability of public liability insurance. In the Ministerial communique that followed, Ministers stated, "unpredictability in the interpretation of the law of negligence is a factor driving up [insurance] premiums".

Debate adjourned.

The DEPUTY SPEAKER: In accordance with sessional orders, debate is interrupted for the consideration of General Business Orders of the Day (for Bills). I set down the resumption of the second reading speech as an order of the day for a future day.

DISCOUNT RATE REDUCTION (MISCELLANEOUS ACTS AMENDMENT) BILL 2017

Second Reading

Debate resumed from 23 February 2017 .

Mr CLAYTON BARR (Cessnock) (10:41): I will continue my second reading speech on the Discount Rate Reduction (Miscellaneous Acts Amendment) Bill 2017. I will briefly recap the intent of the bill. Currently, those people who are deemed permanently injured and receive a lump sum payment have their future earnings on that amount assessed at 5 per cent. It is fact that for many years no-one has been able to earn 5 per cent on your earnings and according to the government bonds that will remain the case for the next 10 years. The rate of 5 per cent is unacceptable. This bill presents 3 per cent as the correct rate.

I have done considerable research to understand what rate is appropriate. I have previously referred to a report titled "Review of the Law of Negligence. Final Report", written by David Ipp and others. One of the arguments to negate this bill is that the cost of paying injured people will increase and therefore the cost of insurance premiums will increase. Mr Ipp was tasked with the responsibility to find ways to drive down the cost of insurance at that time. Following thorough investigation and access to actuaries the report supported 3 per cent as the correct rate. At the time the report was published it was possible to earn 10 per cent on future earnings.

Regardless of the impact on insurance premiums 3 per cent is the correct rate. That is the argument I am making. On page ix of the report the opening paragraph of the "Terms of reference: Principles-based review of the law of negligence" states:

> The award of damages for personal injury has become unaffordable and unsustainable as the principal source of compensation for those injured through the fault of another. It is desirable to examine a method for the reform of the common law with the objective of limiting liability and quantum of damages arising from personal injury and death.

Government members will seek to refute the bill, but the foundation of their argument will be the same argument I rely on to support the bill: the impact on insurance premiums. These esteemed academics were charged with the responsibility to drive down the size and scope of insurance premium payments.

In the face of this basic fundamental instruction they found a discount rate of 3 per cent was appropriate. The Government's arguments to oppose the bill have been considered and dealt with by a panel that was tasked with achieving insurance affordability. I will repeat that in the face of this objective the panel decided that 3 per cent was an appropriate discount rate. That leads to the conclusion that, regardless of the current insurance premium rate, the 5 per cent discount rate is inherently unfair. Why have insurance? Why have the respective Acts? Why have the option of damages if it is fundamentally unfair?

If you want to artificially drive down insurance premiums, you can lift the discount rate to 7, 10 or 12 per cent, cap the damages or remove access to damages claims altogether. That would achieve an artificial effect on insurance. That is not the intent of the insurance itself. It is a question of justice and fairness, and there is an unspoken expectation of the purpose of that insurance, which is that if you are injured the outcome will be reasonable and realistic. At the moment there is no justice, fairness or reasonable realistic outcome with a 5 per cent discount rate applied to the compensation. In truth, the discount rate should have been changed in 2002 when the Ipp report was handed down. At the time long-term government bonds and bank rates were well above 5 per cent, at 10 per cent or more—there was no appetite to change the 5 per cent to 3 per cent as recommended.

Politically it was convenient to have insurance premiums at an artificially lower rate. I say artificially because ignoring the compelling case for a 3 per cent discount rate was an act of negligence by governments of both political persuasions and an act of dishonesty with respect to the insurance premiums we pay. If we fast-forward from 2002 to 2010 the world experienced a financial crisis and interest rates and government bonds crashed. They fell quickly to 6 per cent and then to 3 per cent, and over 12 months the discount rate became inadequate. It occurred regardless of the desire to keep insurance premiums artificially low.

Recognising that the years immediately after the global financial crisis were financially challenging for all jurisdictions of local, State and Federal government and that the discount rate might not have been at the top of the agenda for states and territories, the Parliament has dropped the ball for the past seven years. I bring this bill before the House to address the injustice, whether an error or an oversight. This bill is esoteric and beyond the interest of many who come into this Chamber. The truth is that, for all the huff and puff occurring in this Chamber, this legislation is incredibly important and must be seriously dealt with in detail.

The purpose and intent of the bill is straightforward and its logic is sound. Please do not dismiss this bill simply because it has been introduced by the shadow Minister for Finance in the Opposition. The experts have considered and decided on the correct course of action and all that is left is for us to support this bill.

Debate adjourned.