PRESENT VALUE OF PART 7 BENEFITS

Settlement negotiations occasionally include a deduction of the value of Part 7 (TTD) benefits that are anticipated to be paid in the future, as an offset to an employment income loss claim or award. Rumour has it that rough approximations of the present values of the future Part 7's have been calculated using income loss multipliers as the tool for conversion to present values, in some cases. If that is so, deductions have been too large.

It is our understanding that the Part 7 maximum benefits of $300 per week are NOT indexed to changes in consumer prices or wages, i.e., there are no adjustments to account for wage inflation or for increases in the cost of living. Employment income multipliers implicitly assume (by virtue of the 2.5% discount rate) that incomes will increase more rapidly than price inflation. Multipliers that are based on a 3.5% discount rate implicitly assume that future sums will increase with price inflation.

Recall that the mandated 3.5% discount rate for future sums assumes that returns on invested funds from a lump-sum award will yield a real return of 3.5% per annum — this is equivalent to assuming a nominal rate of interest that is higher than 3.5% per annum, to account for price inflation. For example, if price inflation of 2.5% per annum is anticipated, a real rate of return of 3.5% would be consistent with a nominal rate of return of nearly 6.1% per annum. (The calculation is: ((1.025 x 1.035) - 1) = 0.060875 or 6.0875%.) Higher discount rates lead to smaller present values.

Assuming that future Part 7 benefits will not increase with costs of living (i.e., with price inflation), the purchasing power of the benefits will diminish as a result of price inflation.

Again assuming that price inflation will amount to 2.5% per year in the future, and that a real rate of return of 3.5% per annum can be realized from the investment of a lump-sum award in an exhausting fund, the present value of future Part 7 benefits should be calculated using a discount rate of nearly 6.1% per annum — to account for the erosion of "purchasing power" at a rate of 2.5% per year.

To illustrate the importance of this factor, consider a recent case which involved a male aged 36+. The employment income multiplier to age 65 was estimated at $19,683 per $1,000 per year. A similar "Part 7" multiplier, based on a discount rate of 6.0875% per annum, yields a multiplier of $13,249 per $1,000 per year.

Assuming future Part 7 benefits of ($ 300 per week x 52 weeks) = $ 15,600 per year, the present value would be incorrectly estimated at about $ 307,055 using the employment income multiplier. It would, more correctly, estimated at about $ 206,684 using the "Part 7" multiplier. Use of the inappropriate multiplier will, in this instance, result in a deduction which would be roughly $ 100,000 too large.