A newsletter from NIFA
APPROVED EXPERT FINANCIAL WITNESSES

NIFA NEWS

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NIFA IS PLEASED TO WELCOME A NEW MEMBER

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Peter says: "I am delighted to take on the NIFA mantle in the North East and being able to draw upon the resources of the NIFA network. Having set up Quantis in September of last year, I am pleased to be adding my forensic accounting experience to the NIFA network. I had 9 years as a Director of Deloittes Northern Forensic Group, followed by four years as the in-house Forensic Accountant for the law firm Dickinson Dees in Newcastle. During this time I was a founding member of the North East Fraud Forum, which brought the public and private sectors together to combat fraud. The success of this model is being replicated around the country, with Forums up and running in the South West, North West and East of Scotland and in formative stages in a number of other areas. These partnerships are tackling the global fraud problem at a local level and I would encourage all NIFA members and their contacts to become involved."

NIFA ANNOUNCES THE LAUNCH OF THE NIFA FOCUS GROUPS

NIFA members are increasingly involved in crime! Partly as a result of recent proceeds of crime and money laundering legislation and partly as a result of an increased awareness of fraud and identity theft by members of the public and businesses. To reflect this NIFA has established a crime focus group as a centre of excellence in criminal forensic accountancy. The focus group draws together the relevant knowledge and skills of NIFA members across the country.

NIFA PERIODIC PAYMENTS - COMPARING APPLES WITH PEARS?

The introduction of the new periodic payments regime poses problems for personal injury and medical negligence lawyers trying to advise their clients on the advantages and disadvantages of lump sums compared with periodic payments.

They are now required to consider whether, and to what extent, a periodic payment is preferable to a lump sum. Such a comparison is far from straightforward and has been likened to comparing apples with pears. Solicitors arguably now have a duty to direct their clients to obtain relevant advice so that they can make an informed decision.

Some solicitors consider that the question of which is preferable, a lump sum or a periodic payment, is purely academic, believing that a lump sum will always be better. However, consider an award for damages which settles in the sum of £3 million but is adjourned by the court to allow the parties to consider periodic payments.

In the unlikely event that the defendant were to offer, instead of a £3 million lump sum, a periodic payment of £500,000 per annum, the claimant would be likely to accept with alacrity, assuming he or she believed they were going to live longer than 6 years. Conversely, if the defendant were to offer a periodic

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payment of £10,000 per annum the claimant would give such an offer short shrift. These two extremes serve to demonstrate that there will be a point at which the choice between a lump sum and a periodic payment becomes finely balanced. This article considers how claimants might consider approaching this balancing act.

Firstly, claimants need to identify their true capital requirements, regardless of the amount for which they may or may not be eligible to claim. For example, they may have mortgages, credit card debts or family loans they wish to repay.

Similarly, they may wish to buy a particular motor vehicle or to move house. Once these capital needs have been established it should then be possible to identify the claimants' true income needs. These may differ considerably from the amount that claimants can claim. For example, claimants may be in receipt of permanent health insurance, may wish to educate their children privately, or may wish to economise in respect of certain of the care costs to which they are entitled.

Having established the capital and income needs of the claimant, it becomes possible to address the question of how those needs can best be met and, specifically whether and to what extent they can be met by means of a periodic payment.

NIFA Assessing the needs of the claimant

The rules relating to the calculation of damages in personal injury or medical negligence cases means that they seldom equate to the claimant's needs. Discrepancies may arise for many reasons, including:-

1. *The fact claimants may accept settlement on terms that take into account the deduction for litigation risk in circumstances where a case is settled before trial.*

2. *In cases where there are considerations of contributory negligence, damages claims will usually be reduced.*

3. *In calculating an award for damages there is no need to take account of the income the claimant receives in respect of state benefits or insurance policies.*

4. *Claimants can sometimes economise by relying on care from family members in circumstances where they are eligible to claim for the commercial cost of such care.*

5. *Similarly, claimants may choose to buy second hand medical aids and equipment or make other economies in respect of various items for which they may have claimed compensation, quite legitimately, at full price.*

6. *Claimants can also, on occasion, economise by refraining from attending as many therapy sessions as they have been advised to attend.*

Matching the form of award to the claimant's needs

Claimants must hope that the eventual award includes a lump sum element at least sufficient to meet their capital needs and a periodic payment at least sufficient to meet their income needs. They may also hope that there will be an element of additional damages and, if there are, consideration will need to be given to whether they are paid by way of a lump sum or periodic payments.

In that regard it is important to consider the generic advantages and disadvantages of periodic payments, the most important of which are summarised opposite.

Advantages of periodic payments

1. Periodic payments provide a guaranteed income irrespective of the performance of financial markets. By contrast, the income generated by an investment of a lump sum may fluctuate if it is not invested in risk free securities such as government gilts. Similarly, there is no danger that the income will "run out" during the claimant's lifetime as is the case if compensation is paid by way of a lump sum.

2. Periodic payments are not subject to income tax. Income generated from the investment of a lump sum will be taxable unless invested in a personal injury trust.

3. If the claimant is paid by way of periodic payments, she or he doesn't have to worry about how best to invest it and is therefore relieved of the need to consider investment risks, transaction costs and the cost of professional financial advice.

4. Periodic payments protect claimants from the danger of "squandering" an award for damages in the short term such as to leave themselves with insufficient to meet their basic domestic needs in the longer term.

Disadvantages of periodic payments

1. They preclude the claimant from seeking to achieve returns in excess of the retail price index by engaging in speculative investment.

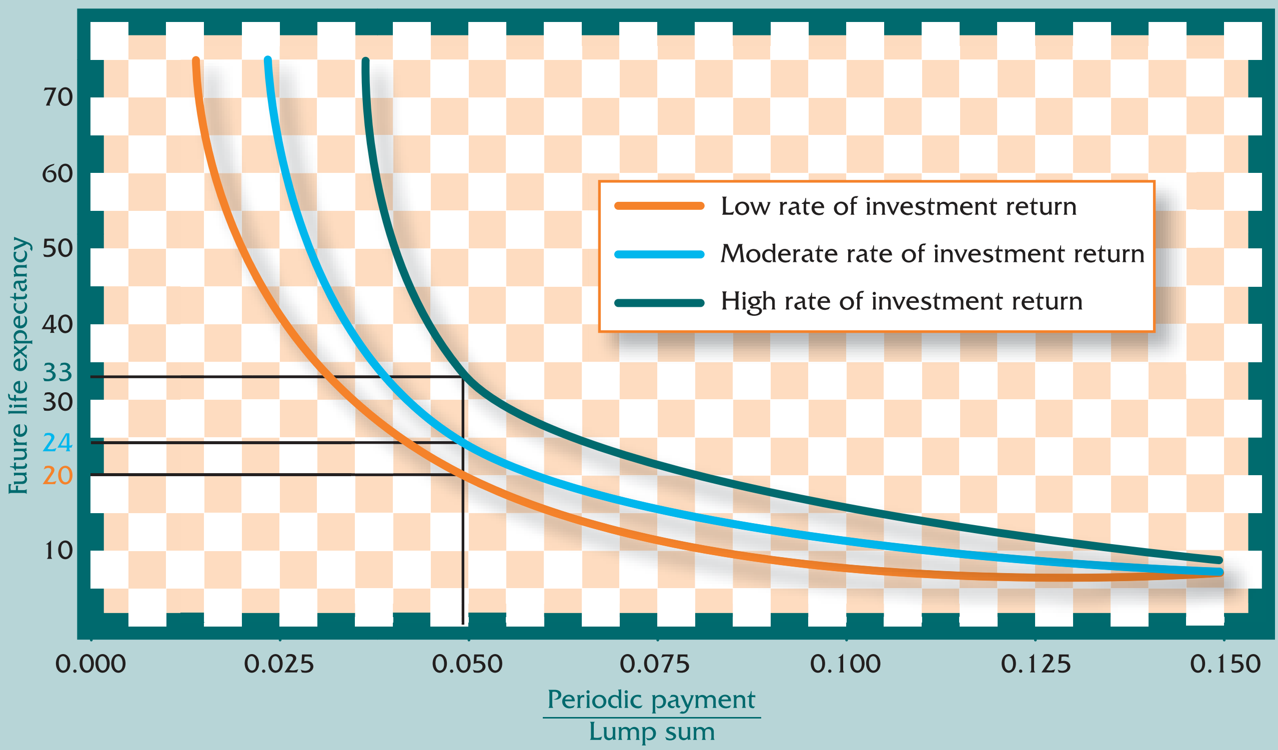
2. They preclude the possibility of a residual sum being available on the death of the claimant, capable of being inherited by the beneficiaries of his or her will. By contrast, if a lump sum is not exhausted at the date of the claimant's death any remaining funds would be so available.

3. Periodic payments can, to some degree, require that a link is maintained with the defendant if it is the defendant itself which is to make the periodic payments. This can be unattractive for some claimants.

4. A lump sum, unlike periodic payments, can be used to fund future capital expenditure.

5. If an award for periodic payments is reduced, because of contributory negligence, a settlement or otherwise, to below the income needs of the claimant, then there is no way for the claimant to meet the shortfall. By contrast, if a claimant is awarded a lump sum, he or she can draw against it at a level sufficient to meet his or her needs in the short or medium term. That said, there will then be a great risk that the funds will be exhausted during the claimant's lifetime.

There are then a further two factors of particular relevance. The first is the claimant's life expectancy and the second is the likely rate of return the claimant would expect to earn on the investment of any lump sum over and above the rate of inflation. In this context the comparison between lump sums and periodic payments can be made with the assistance of graphs such as the one below.



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The relevance of the graph can best be explained by way of an example.

Suppose a claimant wishes to compare an offer of a lump sum of £200,000 with a periodic payment of £10,000 per annum. To use the graph, the periodic payment should be divided by the lump sum as follows:-

$$\frac{\text{Periodic payment, £10,000}}{\text{Lump sum, £200,000}} = 0.05$$

Reading off the graph at 0.05 on the X axis and using the moderate rate of investment return (blue line) gives a figure of 24 years. This means that, at a moderate rate of investment return, a lump sum of £200,000 will last 24 years, if used to provide an annual income of £10,000.

The graph shows that the lump sum will last 20 years at a low rate of investment return (orange line) and 33 years at a high rate of investment return (green line).

If the claimant expects to live for more than, say, 30 years then he or she is probably better off accepting a periodic payment of £10,000 per annum rather than a lump sum of £200,000. Similarly, a lump sum of £200,000 is almost certainly more attractive than a periodic payment of £10,000 if the claimant expects to live less than 20 years.

Graphs such as these can be tailored to specific cases and rely on various assumptions regarding taxation, rates of investment return and rates of inflation.

In summary, what may at first seem to be an impossible comparison, can be broken down into a series of relatively straightforward decisions. Claimants can then approach the question of preference between periodic payments and lump sums with confidence from an informed position.