

ATTACHMENT N - QUANTIFYING CLAIMS

Introduction

Where a claim has meaningful prospect of success, it is necessary to calculate the value of the claim. In broad terms, the calculation determines the amount necessary to restore the claimant to the financial position they would have been in but for the negligent advice. This is the tort measure of compensation for negligent misstatement and reflects how a Court would calculate the loss.

Finance has retained the Australian Government Actuary (AGA) to provide actuarial services to assist with assessment of quantum of a claim.

The nature of the calculations

Employees who did not join Commonwealth superannuation as soon as they were eligible will have their potential retirement incomes impacted in two ways:

- firstly, their actual superannuation benefit will be different from what it would otherwise have been. Commonwealth superannuation benefits are linked in a number of ways to the length of the period of scheme membership. These employees will have had a shorter period of scheme membership than they would have had upon earlier commencement; and
- secondly, since the Commonwealth superannuation schemes are contributory (that is, members are required to contribute to their superannuation), affected employees will have enjoyed the benefit of the use of a higher amount of disposable income during the period before actual scheme commencement than they would have, upon earlier commencement.

Accordingly, it was open to these affected employees to invest that money and save it for retirement.

As a general rule, these factors tend to act in opposite directions. Firstly, joining Commonwealth superannuation later rather than earlier would be expected to result in a lower Commonwealth superannuation benefit and therefore lower retirement income. On the other hand, this gross loss could have been offset to the extent that the saved member contributions were available to be invested for retirement purposes.

The calculations undertaken by AGA roughly follow the path set out below. This is a simplified description of the process that AGA follows. In practice, tailored calculations are required for individual matters and the nature of the calculations can differ substantially from one matter to another.

Outline of calculation process

Firstly, estimate the after-tax superannuation benefit that the employee would have received upon earlier commencement in Commonwealth superannuation. Call this A.

Secondly, identify the actual after-tax benefit that the employee received. Call this B.

Thirdly, calculate $A - B$. This difference represents an estimate of the gross after-tax superannuation loss suffered by the employee as a result of late commencement.

Fourthly, estimate a value of the amount of saved member contributions. Call this C.

Fifthly, calculate $A - B - C$. This represents an estimate of the net after-tax retirement income loss suffered by the employee as a result of late commencement.

Finally, in respect of any compensation paid, the amount includes interest to account for the passage of time. Thus, a claimant is not out-of-pocket even though the claim is resolved after they have accessed their superannuation benefits.

The calculation of item A above can be challenging, particularly because of the complexity of the Commonwealth superannuation schemes.

For example, in order to calculate A, it is necessary to make assumptions about the employee's superannuation scheme (CSS or PSS) and about the employee's choice of benefit structure. These items (which can only be assumed because they relate to the hypothetical circumstance of earlier entry to Commonwealth superannuation) can have a very substantial impact on the value obtained for A. It is not unusual for the claimant to claim that, upon earlier entry, they would have elected the scheme and benefit structure which, with the benefit of hindsight, turns out to be the most valuable even if their actual experience is different from this.

As a result of this, it is not unusual for AGA to be asked to undertake a number of sets of calculations, with each set representing a particular superannuation scheme/choice of benefit structure scenario. In this regard, AGA seeks specific instructions for each of the matters that it deals with individually. The instructions are likely to have regard to the available evidence and to what the claimant is claiming.

Similarly, in some cases there is uncertainty around when the employee might have joined Commonwealth superannuation. This can also lead to further sets of calculations being undertaken, with each set representing a particular candidate joining date.

Required inputs and their status

The Commonwealth's superannuation schemes are complex. Benefits can be linked to some or all of the following:

- employee's scheme – CSS or PSS;
- age of employee at exit;
- length of scheme membership;
- salary from time to time;
- member contribution rate(s) as a percentage of salary;
- fund investment returns;
- mode of exit (resignation, redundancy, retirement, invalidity retirement, death);
- choice of benefit structure (lump sum, pension or combination of both); and
- taxation rules in place at the time of exit.

Since the value of any individual benefit will depend on these factors, they are all potentially required inputs for the calculation of item A in the previous section.

Some of these will be reasonably well known. For example, the age of the employee at exit will be generally known. Fund investment returns throughout the period are also available.

Some of these items may be less well known but capable of reasonably reliable estimation. An employee's salary history might not be wholly available but it might be possible to estimate it with a reasonable degree of reliability.

Other items will not be known. Some of these items can have a very significant impact on the value of A that is obtained. As suggested above, particular items in this category are the employee's scheme and the employee's choice of benefit. For example, pension benefits paid from the CSS may be far more valuable than a lump sum benefit paid from the PSS for a member of a certain age at exit.

To undertake the calculation of item A, it is necessary to make assumptions about these items, including the items which are unknown.

Other assumptions are also required in some matters in order to calculate A. For example, where pension benefits are required, it is necessary to adopt an assumed discount rate to bring the future pension payments to a present value. It is also necessary to make assumptions about the mortality of pensioners.

The calculation of item B can be straightforward as it is, in theory, a known item. If the actual benefit is a pension benefit, then assumptions are required as above around mortality and the discount rate as well as the member's marginal tax rate.

The calculation of item C above presents particular challenges. Item C represents the value of saved member contributions. This is an offset to the loss of superannuation benefits as it refers to the benefit of the use of member contributions which the member would not have enjoyed had they commenced in Commonwealth superannuation earlier.

To estimate the present day value of the saved member contributions it is first necessary to estimate the actual amounts involved. Then it is necessary to bring those amounts to a present day value. This involves allowing for a notional amount of interest. The choice of interest rate is critical here because the timeframes involved are often very long. Even small differences in the assumed interest rate can have a large impact on the calculated value.

AGA seeks instructions on this item. AGA would argue that a reasonable approach is to consider what reasonably available and low risk investment options were available to the employee. For example, if there is evidence that the member was buying property from time to time, AGA would argue for the use of mortgage rates as a way to bring the saved member contributions to a present day value.

Sources and impact of uncertainty

Sources of uncertainty

It is possible to arrive at very different estimates of loss, even when starting with the same basic facts and even when following the same broad approach, as outlined in the first section.

In our experience, the main sources of uncertainty include assumptions around:

- the scheme at exit (CSS or PSS);
- the benefit structure (pension or lump sum); and
- the rate of interest to apply to saved member contributions.

Other items make a difference but usually to a lesser extent. One exception to this concerns the treatment of reversionary pensions. The approach taken by the Commonwealth is to exclude any value in respect of reversionary pensions from the estimate of potential loss. The rationale is that any reversionary pension does not represent a loss suffered by the claimant and that, in any event, it is contingent on the claimant predeceasing their spouse. The Commonwealth also notes that, if the claimant does predecease their spouse, then it would be open to the surviving spouse to make a claim at that time.

Impact of uncertainty

To provide an example of the size of the difference that can emerge in individual matters, the table below sets out estimates of loss calculated by AGA and compared with the claimant's estimates on a number of matters.

For each matter, two AGA estimates are provided. The first estimate is AGA's 'preferred estimate' of potential loss. This estimate represents a scheme/benefit structure scenario that the Commonwealth considers is most likely based upon the available evidence. The second estimate is AGA's 'comparator estimate'. This estimate represents AGA's estimate of potential loss using a scheme/benefit structure scenario preferred by the claimant but using AGA methodology and assumptions (for example, around the rate of interest on saved member contributions). The third estimate is the claimant's estimate of loss. For simplicity, interest is included in each estimate rather than being presented separately.

Matter Number	AGA loss estimate (preferred)	AGA loss estimate (comparator)	Claimant loss estimate
1	\$428,912	\$417,849	\$522,829
2	\$94,087	\$458,927	\$1,196,590
3	\$165,613	\$238,881	\$295,564

Matter 2 clearly illustrates the potential for vastly different estimates, starting with the same basic information. Almost invariably, the claimant's loss estimates will be higher than AGA's loss estimates, sometimes significantly higher. As noted above the main reasons for the differences tend to relate to assumptions around benefit structure and scheme, interest on saved member contributions and treatment of reversionary pensions.

Instructions

AGA is instructed in these matters by the Australian Government Solicitor and DLA Philips Fox. Their instructions are based on what are perceived as realistic scenarios (joining date, scheme at exit and choice of benefit structure). Within that framework AGA is instructed to err, if anything, on the side of generosity to the claimant. Accordingly, where there is some doubt about a particular item or where we adopt an approximation, we will ensure that our approach is biased, if anything, towards the claimant.

Tax

The overall aim is to arrive at an estimate of the potential after-tax loss suffered by the claimant. That is, an estimate of the amount by which the claimant is arguably out-of-pocket.

AGA estimates do not take account of any tax that might be payable on an award of damages or a negotiated settlement. Finance has obtained information from the Australian Taxation Office (ATO) as to how a lump sum settlement payment will be treated by the ATO. The ATO has provided a letter of comfort to Finance which is made available to claimants. The letter says that the ATO will not seek to recoup tax from the lump sum undissected compensation amount received by a *Cornwell*-type claimant.

Shorthand model

During the period 2008-2010, AGA developed a shorthand computer model for use by Finance. That model is intended to allow Finance to obtain a ballpark estimate of the size of the potential loss in straightforward matters. The model was designed to rely on a minimal number of required inputs and, therefore, is relatively unsophisticated.

The AGA has advised Finance against relying on the model output as a sound indicator of the amount of potential loss. It is intended to allow Finance to assess whether or not a particular matter might be a large matter or a relatively small matter and to allow Finance to assess how significant the scheme/benefit structure options are in particular matters.

Discount

These matters are generally 'loss of opportunity matters'. That is, the claimant's claim is based around a loss of opportunity to join superannuation earlier than they actually did. Had they joined earlier, other opportunities may also have been available that were not ultimately available – for example, the opportunity to remain in the CSS and elect a pension benefit. More generally, the claims relate to their loss of opportunity to make certain elections. As such, it is impossible to be precise when estimating possible loss. This is because, often in substantial part, the amount 'lost' will depend on actions taken by the claimant that cannot be known.

AGA estimates do not incorporate any discount to reflect that these matters are loss of opportunity matters rather than straightforward loss matters. It is generally the responsibility of the instructing solicitor to factor in discounts as a part of the negotiation process.