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Connolly Decision Questions Investment Portfolio Assumptions

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Madam Justice Sylvia Corthorn

A recent decision of Madam Justice Sylvia Corthorn, *Connolly v. Connolly and PGT*, 2018 ONSC 5880, has raised important questions about the investment of personal injury settlements for individuals without financial capacity.

The decision addresses a number of other issues, but our focus is on the investment proposal under consideration in the case.

Justice Corthorn declined to approve a Management Plan without, among other things, direct evidence from BMO Nesbitt Burns with respect to its proposed plan for the net settlement funds. In particular, she is seeking evidence from BMO Nesbitt Burns with respect to:

- *The potential negative impact of a downturn in the stock market;*
- *The potential effect of likely cost increases for Taylor Connolly in the future, especially as respects housing and attendant care; and*
- *The potential impact on the investment plan of guardianship costs.*

The suggestion at the heart of the proposed Management Plan was that the BMO Nesbitt Burns investment could outperform a more traditional structured settlement for the injured plaintiff. In commenting on the proposal, Justice Corthorn said: *"I am concerned about the potential for erosion of capital in the Portfolio because of negative movement of the stock market and/or economic events beyond the control of BMO."*

In addition to first-hand evidence from a representative of BMO Nesbitt Burns, Justice Corthorn also said she requires first-hand evidence from a representative of the structured settlement company whose proposals were relied upon for the comparison.

As Canada's largest structured settlement broker, our firm sees countless cases where the parties or a Court compare and contrast a managed portfolio with a structured settlement, to determine which will better meet the injured plaintiff's needs.

At first blush, the managed portfolios often seem superior, but a more robust analysis should always be undertaken. The Connolly decision is one of the few where a Court has given reasons, asking some very important questions about the managed portfolio. In particular, Justice Corthorn has asked to see a projection from the investment manager that actually considers a potential downturn in the markets. ▸▸

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This makes eminent sense. One would never choose a structured settlement after seeing only one possible design or option, yet people often choose not to structure any of their settlement funds, based on managed portfolio proposals that project only consistently positive returns, year after year. These projections are only assumptions and no matter how conservative, do not reflect the reality of investment portfolios in the real world.

In that real world, there are ups, but there are also downs. **A key factor in portfolio performance is invariably the timing of these ups and downs.** This is especially important to those who must consistently spend part of their investment to pay for necessary ongoing expenses.

It is entirely appropriate for a Court to ask for projections on a managed portfolio that factor in potential market downturns occurring shortly after the portfolio is established. Unlucky timing in the form of an early market downturn can mean that the managed portfolio will never recover, even if better returns, in subsequent years, bring the average return back in line with the assumptions.

It would be interesting to see the additional material provided to the Court which factor in a potential market downturn in the near future. Conservative projections might, on the surface, look preferable to a structured settlement, however, bad timing can lead to a disastrously different result for the plaintiff.

Taylor Connolly is likely not someone who can "wait out" a downturn in the markets. Most personal injury plaintiffs require consistent and reliable streams of income from their investments, regardless of whether the market is a bear or a bull. In many ways, these plaintiffs are in the position of retirees, drawing down their investment portfolios. For them, the timing of market downturns is critical. This is why prudent financial planners gradually move to more conservative, fixed income investments, for individuals approaching or in retirement.

When a structured settlement is being considered, the usual practice is to look at many different payout options in order to design a payment plan that will suit a plaintiff's individual and unique funding needs.

Conversely, with managed portfolios, the tendency has been to rely on single projections with assumed rates of return, expenses, and taxes, which appear, on a superficial basis, superior to the structure.

The essence of such assumptions is that reality will almost certainly be both better at times and worse at times. The problem for most plaintiffs is that they cannot afford the risk of bad timing or actual results that underperform the assumptions.

Whether Court approval is required or not, any proposal considered as an alternative to a structured settlement needs to address the following:

- *The potential for early or unanticipated incursion into capital and the consequences to the individual should that occur;*
- *The degree of risk associated with the investment;*
- *The impact of investment or management fees on that investment;*
- *The impact of guardianship fees;*
- *The impact of income tax which is almost always understated (overestimating the extent to which medical expenses can reduce taxes and ignoring the fact that any assumed deferred gains will be taxed eventually); and*
- *The potential impact on access to valuable means-tested benefits such as ODSP, Canada Child Benefit, HST rebates, etc.*

In the Connolly decision, Justice Corthorn reminds us that investment projections **"lack the certainty that a structure provides".**

In light of that observation, decision-makers and counsel assisting injured plaintiffs would be best served by asking financial advisors for more complete projections—projections that show not just best case scenarios, but also consider the very real negative possibilities for injured plaintiffs.