Structured Settlements – What Are They and How has Factoring Harmed Them

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A Structured Settlement is a tool for settling tort and workers' compensation claims that provide claimants with future, tax free payments, typically funded with an annuity, as opposed to an all cash settlement. In addition to the tax benefits, these settlements provide long term security in the form of guaranteed or lifetime payments, are not subject to market fluctuations, and have other potential benefits such as creditor protection. It is often used in conjunction and coordinated with public benefits such as Medicare, SSDI, Medicaid, SSI and state benefits.

Structured Settlements are a means of financial security that allows injury victims to live a life of dignity and not solely dependent on public aid for their future medical care and income. While used on many types of cases, they are frequently used for significant injury cases with future medical needs, wrongful death and settlements involving minors. Injury victims are advised by their attorneys, GAL’s, settlement consultants and financial planners during the process of choosing a structured settlement.
The National Structured Settlements Trade Association (NSSTA) is a national organization made up of settlement consultants and life insurance companies that work to protect structured settlements and their use by injury victims.

NSSTA has worked on factoring issues with Attorneys General and their deputies in California, Illinois, Kentucky, Maryland, Minnesota and North Carolina. NSSTA also worked with the Wisconsin Legislative Council Study Committee on Transfer of Structured Settlement Payments and the NAIC committees addressing structured settlement issues.

NSSTA is a resource for education and technical support on the subject of Structured Settlements.
History of Structured Settlements

Structured settlements first were used in the late 1960s to resolving claims against the manufacturer of Thalidomide.

Structured settlements began to be used more often in the 1970s but did not become commonplace until questions surrounding their tax treatment began to be resolved in 1979 thanks to a series of favorable tax rulings from the IRS. In order to receive the payments tax free, it was understood that under ordinary tax principles the Structured Settlement cannot be cashed out, accelerated or withdrawn.

Congress codified Structured Settlements in 1983 by creating Section 130 of the Internal Revenue Code. The industry grew from a few millions dollars and aiding a few people to a $5 billion business helping tens of thousands of injury victims every year.
Factoring Emerges

Starting in the 1990’s specialty finance companies, referred to as "Factoring companies," began buying up future payments from injury victims with staggeringly high interest rates, in violation of the annuity contract and with no regulation.

Life Insurers issuing Structured Settlement annuities resisted factoring, so factoring companies used thousands of false address changes and power of attorney forms which resulted in hundreds of lawsuits when payees reversed the changes.

By the late 1990’s, the Factoring industry had grown tremendously, spending millions in advertising to attract customers. The Structured Settlement industry was actively battling the Factoring industry in courts across the country.
Structured Settlement Industry Was Damaged by Factoring

- Consumer confusion - Google Structured Settlements and it brings up mostly Factoring companies; most consumer don’t know what a Structured Settlement is, but everyone knows you can get “cash now!”
- High interest rates turn off personal injury lawyers who would rather let clients just waste a lump sum for fear of cashing out the structure and then getting much less because of the huge factoring discount rates
- Created significant operational and legal headaches for life companies:
  - Deals that sell parts or some of payments are challenging to split up
  - Some deals are often done right after settlements even before the annuity paperwork is complete
  - Repeat deals are common (more than half) and confusing and drive up costs
  - Life companies must be careful to check for issues that might preclude a Factoring deal, such as prior court orders, existing child support orders, existing garnishments, Medicare Set Asides, Special Needs Trusts, guardians, divorce decrees, joint payees, irrevocable beneficiaries, previously assigned payments, imposters, sales of workers' compensation payments, competing deals from multiple factoring companies, forged approval orders, etc.
Industry Response

States began to enact Structured Settlement Protection Acts ("SSPAs") to protect consumers from high pressure sales practices, exorbitant interest rates and aggressive collection practices.

Complimentary Federal legislation was passed, creating Section 5891 of the Internal Revenue Code, which passed a punitive 40% excise tax unless a factoring transaction was court approved. The court order had to find that transaction was “in the best interest of the payee, taking into account the welfare and support of the payee’s dependents” and “does not contravene any Federal or State statute or the order of any court or responsible administrative authority.”

However, IRC 5891 and the state SSPA’s, intended to regulate factoring, also had the effect of legitimizing the Factoring industry and unfortunately volume skyrocketed.
Factoring Challenges: What Has Worked?

• Improved judicial review and application of state SSPA’s
• Judicial education
• Stronger SSPA’s in certain states
• National news and related factoring industry scrutiny
  o *Brenston, LaFontant, and Taylor*
  o Paris & Chaikin/Joey Camacho
  o Washington Post articles/Freddie Gray