DO YOU KNOW YOUR ***REAL*** RATE OF RETURN?

As settlement professionals, we often encounter resistance to structured settlements because there is a belief that a higher rate of return can be achieved through private investments. When considering investment alternatives, one must look at four influential factors that affect the **real** rate of return: income tax bracket, inflation rate, management fees and regular distribution.

Let's examine three investment scenarios with the following assumptions:

- guaranteed gross rate of return of 5.0%
- income tax rate of 28.0%
- inflation rate of 1.5%
- trust administration fees of 1.0%.

Under these assumptions, a self-managed investment earning 5.0% would actually only have a 2.1% real rate of return and a professionally managed trust earning 5.0% would only earn 2.05%. By contrast, a structured settlement would earn 3.5% on a guaranteed net basis AND provide regular distribution[i]. In addition, a Cost-of-Living Adjustment (COLA) can be included in structured settlement annuities to offset inflation.

Knowing when to enter the market and when to pull funds out is vital to investment success, particularly in a distribution portfolio. It is a particularly significant challenge for an injured person who depends on a regular income stream to overcome downturns in the market. While real rate of return is an important consideration, so is the ability to regularly draw from the investment while making it last as long as it is needed.

In many cases, injured people are not the typical investor. They do not have a high tolerance for risk. This unique class of investor depends upon income generated by the investment to meet expenses associated with medical treatment, cost of living and, often times, providing for other family members.

Their lost or reduced earning capacity necessitates an income option that is financially secure and certain, with virtually no risk.

The guaranteed and tax-free periodic payments from a structured settlement provide the attractive benefits of a distribution portfolio. The structure gives the recipient the necessary income flow for ongoing needs regardless of any turmoil in the financial marketplace. There really is no match to the certainty a tax-free structured settlement annuity can offer, most especially in uncertain economic times.

As with most things in life, balance is key and a careful analysis of risk tolerance is critical. Once the appetite for risk has been realistically assessed, a carefully-apportioned settlement can be determined for secure, tax-free future payments and for riskier private investments.

To learn more about structured settlements or to discuss a case, please contact Logan & Associates at (248) 865-3900.

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[i] Real Rate of Return can be calculated in three steps.

Step 1. Guaranteed Interest Rate x Federal Income Tax Bracket = Percent Taken in Taxes

Step 2. Guaranteed Interest Rate – Percent Taken in Taxes = Rate of Return After Tax

Step 3. Rate of Return After Tax – Current Inflation Rate = Real Rate of Return