Structured Settlements Best Practices

By James E. Logan, CSSC

In certain instances, structured settlements can be used to mitigate damage claims, especially for lost or diminished income and the cost of future care. A structured settlement that is well designed can provide plaintiffs with greater certainty and security than a cash settlement. It can also give the defense team appreciable added leverage during negotiations. Moreover, a structured settlement can and usually does serve as a bridge over which disputes can be resolved. With this in mind, it is worth refreshing our memories as to why structured settlements act as a "power tool" in your settlement tool box.

❖ TIME VALUE OF MONEY

To illustrate the strength of a structured settlement offer, assume that the plaintiff attorney insists his client must have $2,500 per month for the rest of her life. The client is a 40-year-old female who has a normal life expectancy of 42 years. The attorney demands $1,260,000 cash. You counter by offering a structure that is payable for life with a 30-year guarantee payment period. If the claimant dies during the 30-year period, his beneficiary or estate will receive the remaining guaranteed payments. The cost of a structure would be $702,450. If you convert that into Present Value (PV) terms, the discounted amount needed in today's dollars to invest and receive the same after tax dollars, the claimant would need $854,781. That is $152,331 more than a structure requires to provide the same stream of payments on a guaranteed basis regardless of future shifts in the economy during a 42-year period.

❖ SUBSTANDARD AGE RATINGS

This is an incredible negotiation "power tool" to be used when a claimant has sustained a catastrophic injury or has a non-accident related condition such as cancer, a heart condition, diabetes, etc…. The rated age provides significant added buying power because the person has a reduced life expectancy. If we use the same example as the one above, but we "rate" the claimant as a 55-year-old due to the severe brain injury she sustained, the cost of the structured settlement annuity would be $633,000. If you convert that into Present Value (PV) terms, the discounted amount needed in today's dollars to invest and receive the same after tax dollars, the claimant would need $973,000. That is $340,000 more than a structure requires to provide the same stream of payments. Importantly, the age rating would allow Ford to save an additional $69,450 from the standard annuity rates.

❖ FLEXIBLE SETTLEMENT DESIGNS

One of the things structured settlements enable you to do is to arrange for payments to be made when the money is actually needed. For example, assume a 30-year-old male paraplegic needs a new wheelchair every five years for the rest of his life. The cost of the wheelchair is $5,000 today and the historical inflation rate for durable medical equipment is 4% compounded annually. During his lifetime, it is projected he will need 10 replacement wheelchairs, the last of which would cost in excess of $35,000 due to inflation. The total expected cost for these replacement wheelchairs is $140,932. By funding this with a structured settlement annuity, it would cost $34,915. If the claimant had to invest their settlement dollars and be guaranteed the same series of payments, they would need $80,307 (PV).

Although these are simple examples, you can appreciate the power behind the Time Value of Money, Rated Ages and Creative Settlement design.

- **INCOME-TAX-EXEMPT BENEFITS**

The rate of return, even in this depressed economic period, is typically greater than claimants could otherwise earn through private investments. Keep in mind that unlike 401Ks, IRAs, mutual funds and many other investments ordinary people make, injured individuals almost always need cash flow from the structured settlement annuity. Sooner rather than later, cash settlements will be dissipated because of the need for cash. In the above examples the income-tax-exempt rate of return today is over 3.5%. The taxable equivalent yield is nearly 6%, assuming a combined 35% state and federal tax bracket. That level of return would be very difficult for any of us to achieve, especially if we were making regular withdrawals from our investment portfolio. The fact that the money paid by the structured settlement is income-tax-free and payments will be made as scheduled on a guaranteed basis is a real bonus.

- **SETTLEMENT OF MINORS' CLAIMS**

We believe that settlements for minors should almost always be structured. Not only are the funds protected against misuse, but the parents or guardians are able to avoid making annual reports to the probate court and do not have to post a bond, as required in some jurisdictions. Whether an educational or starter fund is planned to begin at age 18 for several years, the parents will have the peace of mind knowing that their child's settlement will not be squandered when he/she reaches 18.

- **STRUCTURED SETTLEMENT NEGOTIATIONS**

Plaintiff attorneys seem to prefer to negotiate in cash terms as opposed to a combination of cash and structured settlement terms. One might conclude they think they get more money this way. We have seen great success when negotiations address future damages and needs by making offers in a structured settlement format. This enables the parties to recognize that it does not take the amount of money being demanded to respond to the future needs of the injured person. By looking at the settlement in terms of a structured settlement, plaintiff counsel is able to show his client what can be done to protect them financially and that the settlement offer is fair and equitable. This also is a way that helps the parties to bridge the divide that often exists because of various disputed issues such as negligence or the cost of future care.

- **SETTLEMENT CONFERENCES AND MEDIATIONS**

In certain instances, having a settlement consultant attend settlement conferences and mediations can add negotiation flexibility. While the consultant does not become involved with the assessment of case value or of legal issues, they can be valuable when considering how to strengthen offers so that they respond to the unique needs of the injured claimant and their family.

- **WORKING WITH PLAINTIFF BROKERS**

Plaintiff brokers are becoming more involved in settlements than ever before. It is important to recognize that they cannot and must not bind a defendant or their insurer into a financial transaction. Once agreement is reached as to the settlement details, the cost of the annuity must be "locked in" with the annuity provider. This should only be done by the structured settlement broker representing the defendant or their insurer. Likewise annuity applications, assignment documents, settlement agreements, and special settlement terms, should all be originated by the defense counsel or broker. We strongly encourage defense counsel to have the plaintiff attorney or their broker contact us <u>before</u> any structured settlement terms are agreed to and processing begins. There are specific processes and standards that must be followed in order to comply with the requirements of the defendant or their insurer.

❖ SUMMARY

While all settlements do not lend themselves to a structured settlement approach, many more do than are actually structured. When you negotiate with cash you can only negotiate with more cash until you reach a settlement. By employing needs based negotiation techniques, better, more responsive settlements can be achieved while controlling the cost of settlement and overcoming areas that are legitimately in dispute.

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