Vermont Bar Association

Seminar Materials

Vermont's Structured Settlement Protection Act

September 27, 2013
Lake Morey Resort
Fairlee, VT

Faculty:

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REP. THOMAS F. KOCH (R) of Barre,Vermont has served in the Vermont House of Representatives since 1997 after two previous terms from 1977 to 1980. A retired attorney, he has served as Barre town moderator since 1984. Born in Hackensack, New Jersey, Rep. Koch earned his bachelor's degree from Middlebury College in 1964 and graduated from the University of Chicago Law School in 1967. He currently serves on the House Judiciary, Rules, and Mental Health Oversight committees.

Kevin J. Marchand, CPA, Partner
Kevin recently joined MGV Assiciates, Inc. in Colchester, VT after a long career at JMM & Associates. He has strong experience in all aspects of taxation and small business operation. He is a firm specialist in nonprofit organizations and estate and personal financial planning. He graduated with highest honors with a BS Degree in Accounting from Bentley College in Massachusetts in 1978. Kevin is also a member and past president of the Colchester-Milton Rotary Club.

Kevin is an avid sports fan and coaches youth baseball. He and his wife, Julie, live in Colchester and have two sons, Nick and P.J.

Kate Whelley McCabe has been an Assistant Attorney General at the Office of the Vermont Attorney General since 2009, where she has worked in the Civil Litigation and Public Protection Divisions. Currently, Kate does general consumer protection enforcement and lobbying work. Kate received her J.D. from The George Washington University Law School in 2006 and clerked for the Honorable Marilyn S. Skoglund, Associate Justice of the Vermont Supreme Court, from 2007-2009. Kate received her undergraduate degree in English and Economics at Wellesley College in 2000. She lives with her husband, two children, and cocker spaniel in Montpelier, Vermont.

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PROFESSIONAL EXPERIENCE
November 2001-present **Nesbitt & Vassar, L.L.P.**
Partner
Represent clients in commercial/business litigation, business tort, and tort cases, including
prosecution and defense of business and contractual disputes, collection cases, loan and
note cases, real estate disputes, UCC disputes, business torts, and other matters.
June 1997 – October 2001 **Settlement Capital Corporation**
General Counsel, Senior Vice President

Member Board of Directors

· Represented and advised the company on all legal, regulatory, and governmental issues. Managed staff of lawyers and paralegals. Managed outside counsel and government relation consultants for the company. Involved in structuring, arranging, negotiating, and documenting credit lines for the company to acquire financial assets and completed securitizations of portfolio of financial assets. Documented and negotiated other transactions related to operations of company, including debt and equity transactions.

· Responsible for preparing transaction documents and court pleadings and orders for transfer transactions involving structured settlements.

· Represented the company with trade associations and governmental and regulatory bodies and agencies

September 1989 – June of 1997 **Jackson Walker L.L.P., Dallas, Texas**

Partner

Significant experience in all aspects of commercial/business litigation and complex tort cases, including handling dispositive, procedural, and evidentiary hearings in state and federal court, taking and defending depositions, preparation of cases for trial, mediation, and negotiation of settlements. Represented clients in several appeals and binding arbitrations.

Pro bono coordinator/trainer for the firm. Organized firm’s involvement and staffing of South Dallas Legal Clinic for several years. Worked with Legal Services of North Texas, Inc. on numerous projects. Named *Outstanding Pro Bono Lawyer* several times by the Dallas Bar Association. Named *Pro Bono Lawyer of the Year* in 1992 by the Dallas Bar Association.

ORGANIZATIONS

American Bar Association

Business Law Section of the American Bar Association

Dallas Bar Association

State Bar of Texas

EDUCATION

Legal **Texas Tech University School of Law**, Lubbock, Texas

Juris Doctor, May 1989 (Graduated 20th out of approximately 175 students in class)

Undergraduate **University of Texas at Austin,** Austin, Texas

Bachelor of Business Administration, 1983

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Married to Kim Nesbitt (Attorney/Judge) for 15 years; 2 children

Vermont's Structured Settlement Protection Act

Vermont Bar Association
135th Annual Meeting
Lake Morey Resort, Fairlee, Vermont
September 27, 2013

In 2012, Vermont became the 48th State to enact a Structured Settlement Protection Act - a law governing the conditions that must be met in order for a person to transfer periodic payments (obtained in settlement of a tort suit) to a settlement purchaser for a discounted, lump sum amount. Presenters will cover the history of structured settlement sales generally, the basic provisions of the Act, and how the Act has worked so far before opening up a panel discussion on the policy implications of these and related sales.

Speakers:

Rep. Thomas F. Koch, Kevin Marchand; Kate Whelley McCabe; Earl Nesbitt; Hon. Helen M. Toor; Timothy J. Wells; Kate Whelley McCabe

THE SECONDARY MARKET FOR STRUCTURED SETTLEMENTS

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1. Participants in the Secondary Market for Structured Settlements – The participants in the Secondary Market include the following:

   a. The Payee/Annuitant – A Secondary Market Transaction starts here. The Payee/Annuitant is typically, but not always, the original settling plaintiff/injured party in the underlying structured settlement arrangement and is typically the seller/assignor in the Secondary Market Transaction.

   b. Structured Settlement Obligor – The Structured Settlement Obligor is the party actually obligated to make the future, periodic structured settlement payments. In most cases, this is the Qualified Assignee, but in some situations it could be one of the original Settling Parties, such as the settling defendant's liability insurance carrier.

   c. Qualified Assignee – This is the party that assumes the obligation, from the settling defendant and/or the settling defendant's liability insurance carrier, to make the future structured settlement payments by way of a Qualified Assignment. Typically, this is the Structured Settlement Obligor.

   d. Annuity Owner – The owner of the funding Annuity. This is usually the Qualified Assignee. In a real, statutory compliant structured settlement, the Payee NEVER owns the funding annuity.

   e. The Annuity Issuer – The life insurance company that issued the annuity to fund the obligation of the Qualified Assignee/Structured Settlement Obligor/Annuity Issuer to make the future, structured settlement, periodic payments to the Payee.

   f. Funding Companies – Also referred to as "factoring companies" or "transferees." The Funding Companies are in the business of acquiring and/or arranging structured settlement receivables – Secondary Market Transactions. The Funding Companies contract with Payees and secure court approval of the transactions.

   g. Judges/Courts – All traditional (statutory compliant) structured settlement

transfers must be court-approved in 48 of 50 states in order to be effective and enforceable under applicable state laws. In any event, a structured settlement transfer that is not court-approved, even in the two states without a transfer statute, would be subject to a 40% Federal excise tax. Court approval is a required part of the Secondary Market.

h. State Legislatures – A decision was made long ago, as the Secondary Market was growing into a nationwide industry, that regulation of the Secondary Market was going to be on a transaction-by-transaction basis through State Structured Settlement Transfer Statutes, such as 9 V.S.A. §§ 2480aa-gg (the "Vermont Transfer Statute").

i. Congress – Congress provided the framework, as well as the carrot and stick, for enactment of State Structured Settlement Transfer Statutes when it enacted 26 USC 5891. Section 5891 provided the stick, by assessing a 40% excise tax on transferees (the Funding Companies) involved in structured settlement transfers, and the carrot by providing a safe harbor (i.e. no assessment of the excise tax) for transactions that were court approved under an "applicable state statute" in an "applicable court order." The actions of Congress in enacting 26 USC 5891 also provided an incentive for State Legislatures to enact Transfer Statutes.

j. National Association of Settlement Purchasers (NASP) – NASP was created in 1996. It is the only trade association for the Secondary Market. NASP has 16 Funding Company members and its members constitute an estimated 90% to 95% of the Secondary Market. NASP also has approximately 90 or so "affiliate members," primarily attorneys who are involved in the Secondary Market around the country, but the affiliate members also include financial advisors, servicing entities, and others who are involved in the Secondary Market.

   NASP and its members actively supported and were instrumental and actively involved in the enactment of State Transfer Statutes around the country and Federal legislation (26 USC 5891) relating to structured settlements. NASP remains active in monitoring and responding to legislation and in promoting the Secondary Market and educating the public about same.

k. The IRS – The IRS enforces 26 USC 5891, primarily by conducting audits of Funding Companies.

2. <u>The Secondary Market – The Early Days</u>

   a. The absence of flexibility and viable, available liquidity options for Payees relative to structured settlement payments provided the genesis of the Secondary Market for structured settlements. In the early 90's, some entrepreneurs discovered and identified this lack of liquidity relative to structured settlements and the "Secondary Market" was created. In the early days of the Secondary

Market, most transactions were arms-length, contractual transactions, whereby the Payee/Annuitant would contractually agree to assign to a third party (the originator/funding company) the right to receive future structured settlement/annuity payments in return for a cash payment. No court approval of the transaction was required.

b. The manner in which transactions were completed in the pre-court ordered market left open the possibility that the assigned payment stream could be interrupted if the Payee breached their contractual and/or legal obligations to the Funding Company. This would usually lead to litigation with the Payee, which often resulted in a default judgment against the Payee, followed by additional legal post-judgment proceedings (i.e. garnishment, attachment, turnover order, etc.). The process was expensive and time consuming for all concerned.

c. A number of "myths" arose relative to structured settlements (i.e. that they were used only or primarily to settle cases involving severely injured plaintiffs who would never recover from their injuries and would never be able to work or support themselves and their family again) and the Secondary Market (that discount rates of 30, 40, or 50% were applied in Secondary Market transactions). These simply were not true.

3. The Advent of Court Approval of Secondary Market Transactions

a. In early 2001, following some sporadic legislative and court battles relating to the Secondary Market, with uneven, uncertain results, a "legislative compromise" was reached to try and bring some uniformity, structure and consistency to the Secondary Market. The intentions of the parties promoting the legislative compromise was to instill some consumer protection provisions in the process, bring some certainty to the process, insure that all interested parties were provided notice of the transfer BEFORE it was consummated, try and avoid expensive and time-consuming litigation after the fact, and resolve any lingering tax uncertainty about the transactions.

b. The specific objectives of the legislative compromise were to require all structured settlement transfers to be court-approved under an applicable State Transfer Statute. In addition, Federal law was amended to (i) impose an excise tax on all transfers that were not court-approved under an applicable State Transfer Statute; (ii) provide that a Secondary Market Transaction did NOT create any adverse tax consequences to any of the original parties to the structured settlement, whether or not the transfer was court-approved; and (iii) clarify that a prior concluded secondary market transfer transaction did not create any adverse tax consequences to the parties to the structured settlements at issue in those prior transactions.

c. Essentially, what occurred was:

i. A model structured settlement transfer statute was drafted, negotiated, and approved by all interested parties and efforts were undertaken to have a Model Transfer Statute approved by the National Conference of Insurance Legislators (NCOIL), which would provide consumer protection and require court approval of all transaction.

ii. NCOIL enacted a Model Transfer Statute that is still in existence to this day and which formed the basis of most State Transfer Statutes.

iii. 26 USC 5891 was enacted in early 2002, which imposed an excise tax on transfers of structured settlement payment rights UNLESS such transactions were completed in accordance with an applicable "state transfer statute." An Applicable State Transfer Statute must require that the proposed transfer be approved by a court order

4. State Court Transfer Proceedings Today

a. Court proceedings under the State Transfer Statutes are typically summary proceedings, but do involve the presentation of evidence, where the issues before the court are limited to a determination of whether the transferee has complied with the statute, whether the transfer is in the payee's best interest, and any other issues/objections that relate directly to the question of whether the proposed transaction should be approved.

b. Most of the time, the "Structured Settlement Obligor," "Annuity Owner," and/or "Annuity Issuer" (all of which are considered to be "Interested Parties") choose to remain neutral in the transaction and do not oppose or support the transfer.

c. Structured Settlement Obligors, Annuity Owners, Annuity Issuers (collectively the "Insurance Parties") and transferees may request and negotiate a separate settlement agreement or stipulation, signed by Transferee and Payee, or certain language in the Final Order. These stipulations/agreements are usually not filed in Court.

d. Language that is sometimes requested/required in stipulations, settlement agreements or orders (by Insurance Parties or Transferees) include:

   i. Unequivocal release, indemnity, and discharge language of the Insurance Parties.

   ii. Specific representations about the disclosure statement, transfer agreement, independent professional advice, filing of the Notice and Application, contents of transfer agreement.

   iii. Most Insurance Parties now require payment of an administrative fee. Ranges from $ 500 to $ 3,000. Typically around $ 750 to $900.00. The amount of the administrative fee is NOT typically tied to the size of the underlying transaction.

iv. Some may reference and/or require an acknowledgment letter from the Annuity Issuer/Structured Settlement Obligor.

v. The Stipulation and Order may refer to subsequent assignees/payees.

vi. Some Stipulations and Orders reference transfer statutes in other jurisdictions.

e. It is imperative that the transaction and the order/court proceedings comply with 26 USC § 5891 and that the court order reflects compliance with 26 USC 5891. This is important to insure that the transaction is not, inadvertently, subject to an excise tax assessment.

f. The order should specifically and accurately describe the payments to be transferred (i.e. the "Assigned Payments.")

g. The order should include any specific findings required by the applicable State Transfer Statute.

h. The court should specify payment instructions/address and, if applicable, the assignee.

i. "ABC Funding has assigned to XYZ Investments its interest in, including the right to receive, the Assigned Payments and the Annuity Issuer/Structured Settlement Obligor shall make the Assigned Payments to ABC Funding's designated assignee, XYZ Investments, at 123 Main Street, Houston, Texas 78754."

i. One may want to include language regarding "Assigned Payments" that come due and owing prior to the date of the hearing. For example, if the hearing is set for February 19, 2011, but when the transfer agreement and disclosure statement was signed in October of 2010 the parties contemplated that the 60 monthly payments to be transferred and assigned would begin with the December 1, 2010 payment.

i. "If Insurance Parties have previously made any of the scheduled Assigned Payments that have come due and owing under the Settlement and Annuity prior to the date of this final order (for instance, if the December 2010 and January and February 2011 monthly payments have already been made to [payee]), it is ordered and adjudged that Insurance Parties have fulfilled their payment obligations with respect to said payments."

ii. We urge our clients to try to avoid this by scheduling the Assigned Payments to begin far enough in advance to get contract and disclosure signed and get Application filed, hearing scheduled, and order signed prior to due date of first Assigned Payment.

j. Many Applications reference prior court orders and prior court-approved transactions involving the transferee and the payee and the payee and third parties, to the extent those are known to the transferee.

k. The reality is that the impact of court approved transfers of structured settlement payments on structured settlement obligors, annuity owners, and annuity issuers is minimal.

  i. Transfers do not alter or change the mode, manner, amount, or timing of the Assigned Payments. The Insurance Parties make the payments in the same amounts and on the same payment schedule as they were originally scheduled. The only difference, in most transfers, is the check/payment is sent to the transferee rather than the payee. Sometimes the annuity issuer will agree to split payments, but usually they cannot be compelled to do so.
  ii. Most State Transfer Statutes provide that if the transfer is approved, then the Insurance Parties are discharged and released from any and all liability for the transferred payments as to all parties except the transferee.
  iii. Moreover, the transferee must indemnify the structured settlement obligor and the annuity issuer for any other liability or costs arising from said parties' compliance with the court order.

l. If an annuitant/payee has some flexibility with respect to their future structured settlement payments, pursuant to a process that requires court review of all transfers of such payments, then structured settlements will be more valuable, useful, and appealing to such individuals and their counsel.

m. Best interest considerations.

  i. A determination of best interest is dependent on the facts of each case and the circumstances of the payee. Many factors can and will impact this determination. Obviously, the financial and personal circumstances of the payee and their reasons for pursuing the liquidity option are the most relevant and important factors. Some deference should be given to the desires of the Payee relative to management of their own financial affairs.
  ii. Counsel and their client (the transferee) presumably do not want to go to court with deals that are likely to be denied, as it is a potential waste of time and money.
  iii. Hopefully, the transferee has done a good job of underwriting and evaluating and structuring the transaction to insure that the parties have a good chance of succeeding when they go to court.
  iv. We tell our clients that in every transaction the transferee has two (2) customers – the payee and the court. We have to convince both customers that the transaction is appropriate and satisfactory.

c. Other parties could have an interest or claim in the Assigned Payments. Issues with such other parties relative to such interests or claims

eventually land at the feet of the transferee, and hopefully can be dealt with before the deal is closed

i. Transferees should check UCC filings to see if anyone else is claiming an interest in any of the payments due and owing under the structured settlement, including payments that are not part of the Assigned Payments to be assigned to the transferee in the pending court proceeding.
ii. Many companies who have taken an assignment or security interest in structured settlement payments, particularly those that took such assignments or interests prior to enactment of transfer statutes requiring court approval of such transfers, file a UCC Financing Statement evidencing said interest.
iii. Obviously, the same issues/problems that one might have with any UCC filing apply to UCC filings relative to structured settlements – payee has moved, misspelled names, intervening creditor, etc.
iv. Prior court orders involving the payee and the payments in question should be provided to the transferee by the insurance company, but that does not always happen.

5. Factors Affecting Pricing

Many factors affect the retail price of a Secondary Market transaction, including:

a. Cost of funds – Funding Companies must finance their acquisition of these assets. The cost of funds is a key component of the pricing of these transactions.

b. Timing and Amount of the Payments -- History and experience tells us that monthly payments that commence immediately and run for 10 years or so are much preferred by those who finance the acquisition of these receivables. Thus, the discount rates offered Payees/Annuitants for these types of payment streams are typically lower, meaning higher purchase prices paid to payees. When payments do not start for several years, or run for 20 years or more, or if the payments streams are uneven, the discount rates are going to be higher.

a. Larger transactions are typically bid more aggressively in the Secondary Market than smaller transactions. However, the out-of-pocket costs for securing court approval of these bigger transactions are, for the most part, not significantly higher than for smaller transactions.

b. The identity of the Annuity Issuer is obviously important, as the creditworthiness of the party obligated to make the future payments to be transferred/assigned is an important factor in determining whether the asset is one that should be acquired and at what rate/yield. Typically, we are talking about the financial condition, creditworthiness, and ability of

the Annuity Issuer to meet its financial obligations and make the future annuity payments.

c. Annuity Owners/Qualified Assignees are often wholly-owned subsidiaries of the Annuity Issuer, and often simply an entity created solely and exclusively to assume the structured settlement/payment obligations due under the Settlement Agreement/Qualified Assignment and to "own" the funding annuities.

d. Likelihood of court approval – There are, quite simply, jurisdictions where securing court approval of a transaction is much more difficult and expensive than others. There are Judges who simply feel that no transaction could ever be in the "best interest" of the Payee because the Payee is taking a discounted lump sum payment in return for future payments that far exceed the lump sum. Inevitably, the discount rates offered Payees in these jurisdictions is higher (and thus the purchase price is lower) because of the increased risk in getting the transaction approved.

    i. My belief is that Judges do not remember the 10 deals you brought to them and they approved because they made sense for the Payee; rather they remember the one awful Payee or deal that should have not been brought in court.
    ii. Funding Companies should ask themselves if they are willing to risk annoying a Judge by bringing a single transaction that has a low probability of approval, small profitability, and the potential to poison a particular jurisdiction against the Funding Company or the industry before moving ahead.

e. Many other factors can affect pricing, including general market and economic conditions and expectations, inflation, regulatory and legislative and legal developments/trends in particular jurisdictions and all of the risks identified herein.

f. Risks of the asset also impact pricing – some examples

g. <u>Obligor Risk</u> – Whether the annuity issuers – MetLife, AIG, Allstate, etc., – will be able to pay their obligations to policy holders in the future.

    i. As an example of Obligor Risk, an insurance company that was unable to continue as a going concern, but which was active in the issuance of annuities, included structured settlement (fixed) annuities, consider Executive Life of New York (ELNY).
    ii. ELNY went into receivership (which is sort of a bankruptcy for insurance companies) in 1994. From 1994 through 2010, ELNY paid 100 cents on the dollar on every structured settlement annuity it had issued, notwithstanding the ongoing receivership proceedings. The company

remained in receivership for a long time, administered by the Liquidation Department of the New York Department of Insurance, with court oversight from a New York State court in Nassau County, New York. Transfers often had to be approved in the State Court and in Nassau County, by the court and/or the administrator.

iii. With the economic downturn and recession in 2008 and 2009, ELNY's financial condition deteriorated. At one point, the liabilities of ELNY were estimated to be in excess of $2 Billion, with assets available to pay those claims being around $950 million.

iv. A plan to liquidate ELNY and complete the rehabilitation of the company was approved, which involved transferring assets to a new entity (Guaranty Association Benefit Company), which would be responsible for paying future claims – i.e. mostly structured settlement and other annuities. Additionally, various third parties, such as annuity owners, guaranty funds, and industry bail-out consortiums, agreed to contribute assets/funds to ELNY to assist in the rehabilitation/liquidation of the company. Some of these "contributions" may have been voluntary, others may have been legally (or arguably legally) required.

v. However, the claims of some ELNY stakeholders would be reduced. For instance, and most notably for the Secondary Market, assignees of Payees (such as those who acquired ELNY structured settlement/annuity payment rights in Secondary Market transactions) will receive reduced payouts. The amount of the haircuts varies depending on the amount and timing of the structured settlement payments and other issues.

vi. But the bottom line is that assigned structured settlement payments due and owing by ELNY will be discounted and discounted more than payments to the original Payees (those that were unassigned). Some of the discounts will approach 50% to 65%.

vii. Other structured settlement annuity issuers that have gone into receivership include Reliance, Executive Life of California, Confederation Life, and Monarch Life.

h. <u>Deal Risk --</u> The nature of the Secondary Market for structured settlements is such that it is very difficult to buy a pool of "plain vanilla, cookie-cutter" deals. Some of the variables involved in a Secondary Market transaction are as follows:

i. The applicable law – i.e. the case was settled in Texas, the payee/annuitant now lives in Vermont, the annuity issuer is in New York, and the structured settlement obligor is in Illinois. All of those states have different structured settlement transfer statutes, which may or may not be applicable (or which some interested parties believe may be applicable).

i. The settlement documents – most structured settlements involve a settlement agreement, a qualified assignment, and an annuity, but some structured settlements are approved by court order when they

are set up (i.e. those involving a minor), some don't have qualified assignments, sometimes the settlement is so old that the settlement agreement cannot be located, with some the annuity was originally issued by one company and later assumed by another, etc.

ii. Annuity issuers/obligors Secondary Market policies and practices. Some issuers/obligors require stipulations with Funding Companies. Some of those stipulations include indemnities and hold harmless obligations, mortality verification obligations, and require payment of administrative fees. Issuers/obligors require certain language in their court orders. The ramifications of those stipulations and court orders cannot be understated.

iii. Examples of underwriting issues include:

- Is the deal a workers compensation deal?
- Does it involve an "irrevocable beneficiary"?
- Was it a minor settlement?
- Has the Funding Company complied with all applicable transfer statutes AND Federal law? Assessment of an excise tax is a deal killer; and that could happen years after the deal was completed.
- Does the Funding Company feel comfortable that the payment stream that is being acquired is free and clear of any liens?
- Identity of the obligor/issuer. Some are more difficult to work with than others. Administrative fees?
- Divorce, bankruptcy, and probate issues?
- Life contingent payments.
- Servicing issues.

i. Liquidity Challenges

ii. The one characteristic of structured settlements upon which the Secondary Market was created is the lack of liquidity for the payee/annuitant. Unfortunately, that is also a problem for those originating and/or investing in these assets/receivables.

iii. Because of the manner in which these transactions are originated – i.e. through the court-ordered process – there are issues with liquidity.

iv. With some exceptions, once a court order designates an assignee on a structured settlement transfer, it is extremely difficult to change that assignee via a change in the court order.

v. Moreover, many annuity issuers/owners will include language in the order or stipulation that prohibits a further change of assignees or payees (even if they allow a subsequent assignment).

Glossary of Terms – Summary of Structured Settlements
(Used in Presentation by Earl S. Nesbitt –
Secondary Market for Structured Settlements)

- Annuitant – A person entitled to receive annuity payments from an Annuity Issuer. In the context of a structured settlement, the Annuitant is typically the settling plaintiff and Payee, however the Payee may also be a beneficiary of the original Annuitant if the original Annuitant (and original payee) died after the structured settlement was set up.

- Annuity – A contract issued by a life insurance company which provides for future periodic payments. The payments due under the Annuity may be monthly payments or periodic lump sum payments (i.e. annual payments, semi-annual, every 5 years, etc.). The payments may be for a period certain or life-contingent (i.e. due for the life of the Payee/Annuitant). Monthly payments may include an annual percentage increase.

- Annuity Issuer -- A life insurance company that issues a contract (typically an annuity) to fund the obligation to make future structured settlement payments to a Payee. Typically, the Annuity Issuer makes the annuity payments directly to the Payee.

- Annuity Owner -- The owner of the annuity issued to fund structured settlement payments due and owing to a Payee. The Annuity Owner is also often referred to as the Structured Settlement Obligor.

- Applicable State Statute – A term used in 26 USC 5891 referring to state transfer statutes which governs the transfer and assignment of structured settlement payment rights. A transfer must be completed in accordance with an Applicable State Statute in order to be exempt from the excise tax imposed by 26 USC 5891. In Vermont, 9 V.S.A §§ 2480aa-gg (the "Vermont Transfer Statute") would be the relevant Applicable State Statute.

- Disclosure – A written document that must be provided to the Payee by the Funding Company/Transferee before the Payee signs a Transfer Agreement. The Disclosure Statement sets forth the main financial terms of the transaction. Under the Vermont Transfer Statute, the disclosure statement must be provided to the Payee at least ten (10) days prior to the date on which the payee signs a transfer agreement.

- Funding Company – Also referred to as a Transferee. The Funding Company/Transferee will agree to pay to the Payee a lump sum payment in return for the transfer/assignment of certain specified structured settlement/annuity payment rights.

- Independent Professional Advice/Advisor (IPA) – A term of art used in structured settlement transfer statutes. Payees are typically admonished and advised that they have the right to receive independent professional advice or consent with an independent professional advisor regarding the proposed transaction involving the transfer of the Payee's structured settlement/annuity payment rights to the Funding Company. In Vermont, the IPA may be provided by an attorney, CPA, actuary, or other licensed professional adviser.

- Payee – A person who is entitled to receive tax-free (under 26 USC 104) structured settlement/annuity payments in connection with a structured settlement. The term Payee is used in Applicable State Statutes and describes the person seeking to transfer/assign structured settlement/annuity payments to a Transferee.

- Primary Market – Refers to the business/market of setting up structured settlements in connection with the settlement of a lawsuit/claim. Participants in the Primary Market would include the plaintiff/claimant, plaintiff's attorney, the defendants in the underlying lawsuit, the defendant's casualty insurance carrier defense counsel, a Qualified Assignee, Structured Settlement Obligor, Annuity Issuer, Annuity Owner, structured settlement broker, and other parties. In recent years (i.e. 2005 to 2007), the size of the Primary Market was reported as being around 6 Billion Dollars per year. Now it is probably closer to 4.5-5.0 Billion Dollars per year.

- Qualified Assignee – A party that has assumed the obligation to make future structured settlement payments to a Payee by virtue of a Qualified Assignment in accordance with 26 USC 130.

- Qualified Assignment – The assignment to a Qualified Assignee of the obligation to make future structured settlement payment rights to a Payee by a party to a Settlement Agreement in accordance with 26 USC 130.

- Secondary Market – Refers to the business/market of providing liquidity options to Payees relative to their structured settlement/annuity payment rights. Secondary Market transactions are completed through the court approval process in accordance with an Applicable State Statute – a state structured settlement payment transfer statute.

- Settlement Agreement – In the context of a "structured settlement," a Settlement Agreement settles a lawsuit and requires, in part, the settling defendant to make future structured settlement periodic payments to the Payee.

- Structured Settlement Obligor – The party that is obligated to make the future structured settlement payments to the Payee (the settling plaintiff) in connection with the underlying structured settlement. Typically, the Structured Settlement Obligor has assumed the obligation to make the future structured settlement payments to the Payee from a party to the underlying settlement and Settlement

Agreement. The settling party may have assigned to the Structured Settlement Obligor the obligation to make the future structured settlement payments by virtue of a Qualified Assignment and may therefore also be referred to as a Qualified Assignee.

- Transfer Agreement – The contract between the Payee and the Transferee providing for the transfer/assignment of structured settlement payment rights. The Transfer Agreement is typically filed with the court in connection with a transfer.

- Transferee – The party who has agreed to acquire structured settlement/annuity payments from a Payee in connection with a structured settlement transfer. The Transferee is also referred to as a Funding Company.

Summary of Structured Settlements

a. Structured settlements generally describe a method of settling tort claims in a manner that involves payments by the defendant (or defendants' liability insurance company) to the plaintiff over many years, rather than in a single lump sum payment at the time of the settlement. The structured settlement may occur before a formal lawsuit has been filed, by virtue of a settlement while the case is pending, or after the case has gone to trial and been decided by the court.

b. "Structured settlement" most often refers to a settlement of a tort claim or lawsuit whereby the defendant and/or defendants' insurance company (the "Settling Parties") enter into a settlement agreement with the plaintiff which provides for the Settling Parties to make future periodic payments over time (the "Settlement Payments") to the plaintiff. The key component is that there is not a single lump sum cash payment to the settling plaintiff; rather the compensation or settlement payment is "structured" – i.e. paid over time.

c. Most often, but not always, the Settling Parties will assign the obligation to make the future periodic "structured settlement" payments to third party, a Qualified Assignee, pursuant to a Qualified Assignment. Once the Qualified Assignment is made, the Settling Parties are released from any further liability under the original settlement agreement. The Qualified Assignee is typically a wholly-owned subsidiary of a life insurance company. Once the Qualified Assignment occurs, the Qualified Assignee is obligated to make the future structured settlement payments to the settling plaintiff.

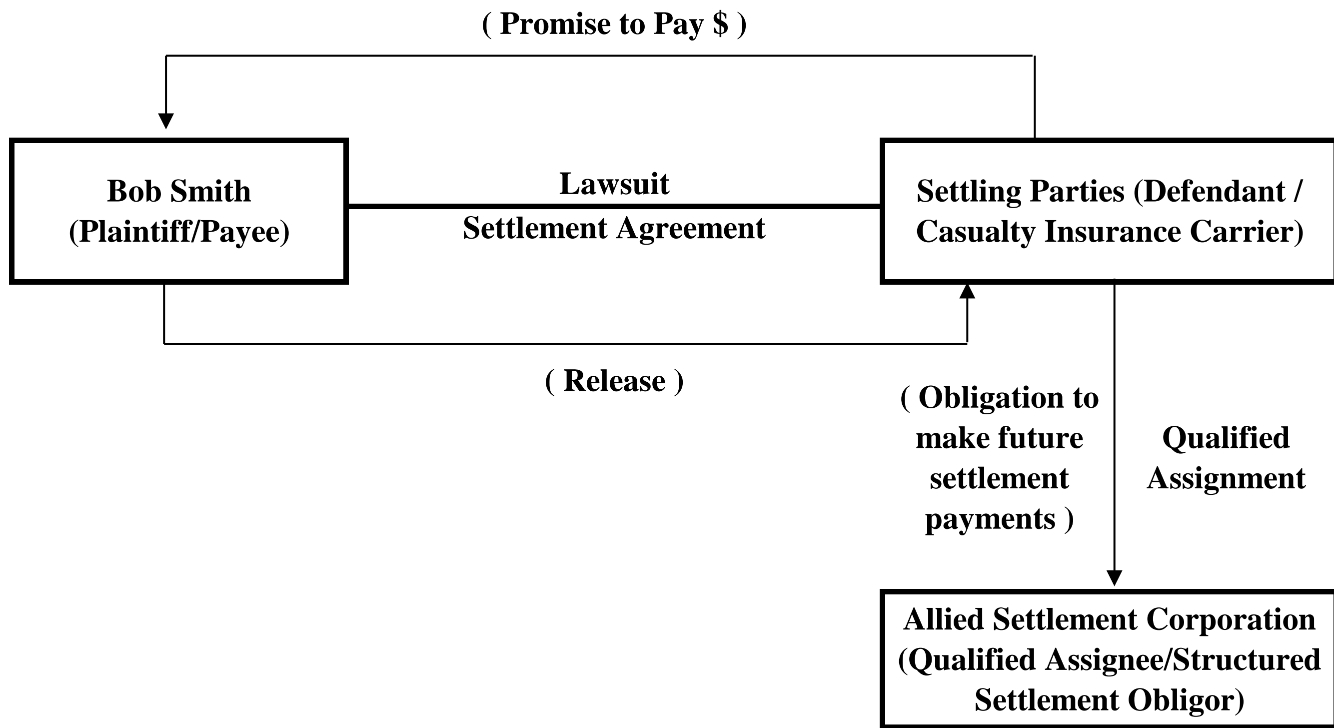
d. The Qualified Assignee then typically purchases an Annuity from a life insurance company. The Annuity provides for periodic annuity payments

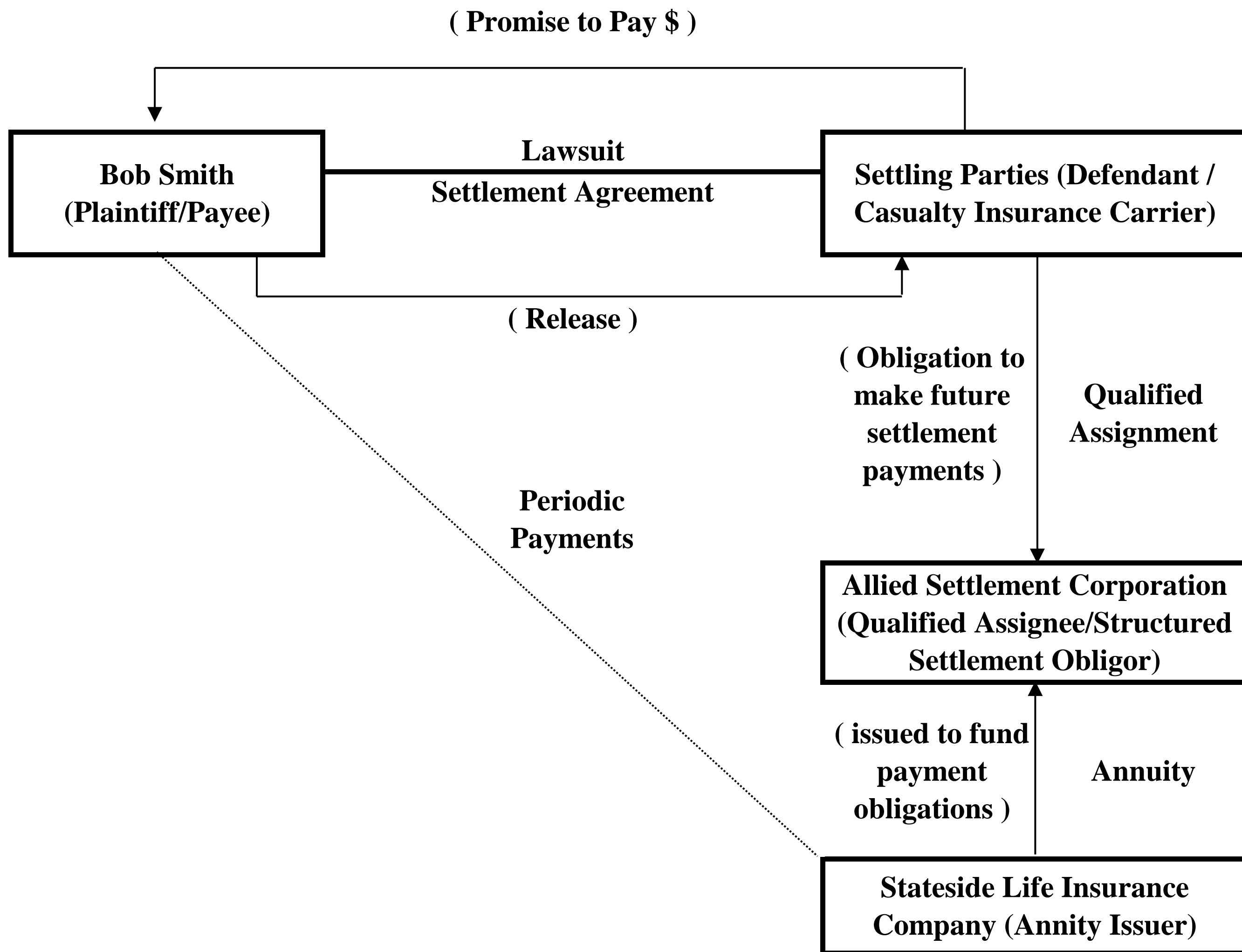
to be made to the Payee/Annuitant in the same amounts and on the same dates as set forth in the settlement agreement and/or Qualified Assignment.

e. The owner of the Annuity is the Qualified Assignee, but the settling plaintiff is the named Payee/Annuitant and the person entitled to receive the future annuity payments. The Payee/Annuitant's rights to receive the annuity payments is not based on ownership of the Annuity, but rather as the Payee/Annuitant entitled to receive the annuity payments in satisfaction of the Annuity Owner/Qualified Assignee's obligation to make the future structured settlement payments. This type of arrangement allows the parties to enjoy certain tax and other benefits.

f. The main disadvantage of the structured settlement arrangement is that the future payments are illiquid for the Payee/Annuitant and the Payee/Annuitant has limited flexibility relative to his/her interest in this intangible property right. Because of certain legal and tax restrictions imposed on the parties to a structured settlement by the Internal Revenue Code and other practical issues, once a structured settlement is created, the parties are legally precluded from increasing, decreasing, accelerating, or deferring any of the future structured settlement payments.

(Promise to Pay $)
Bob Smith
(Plaintiff/Payee)
Lawsuit
Settlement Agreement
Settling Parties (Defendant /
Casualty Insurance Carrier)
(Release)


(Promise to Pay $)
Bob Smith
(Plaintiff/Payee)
Lawsuit
Settlement Agreement
Settling Parties (Defendant / Casualty Insurance Carrier)
(Release)
(Obligation to make future settlement payments)
Qualified Assignment
Allied Settlement Corporation
(Qualified Assignee/Structured Settlement Obligor)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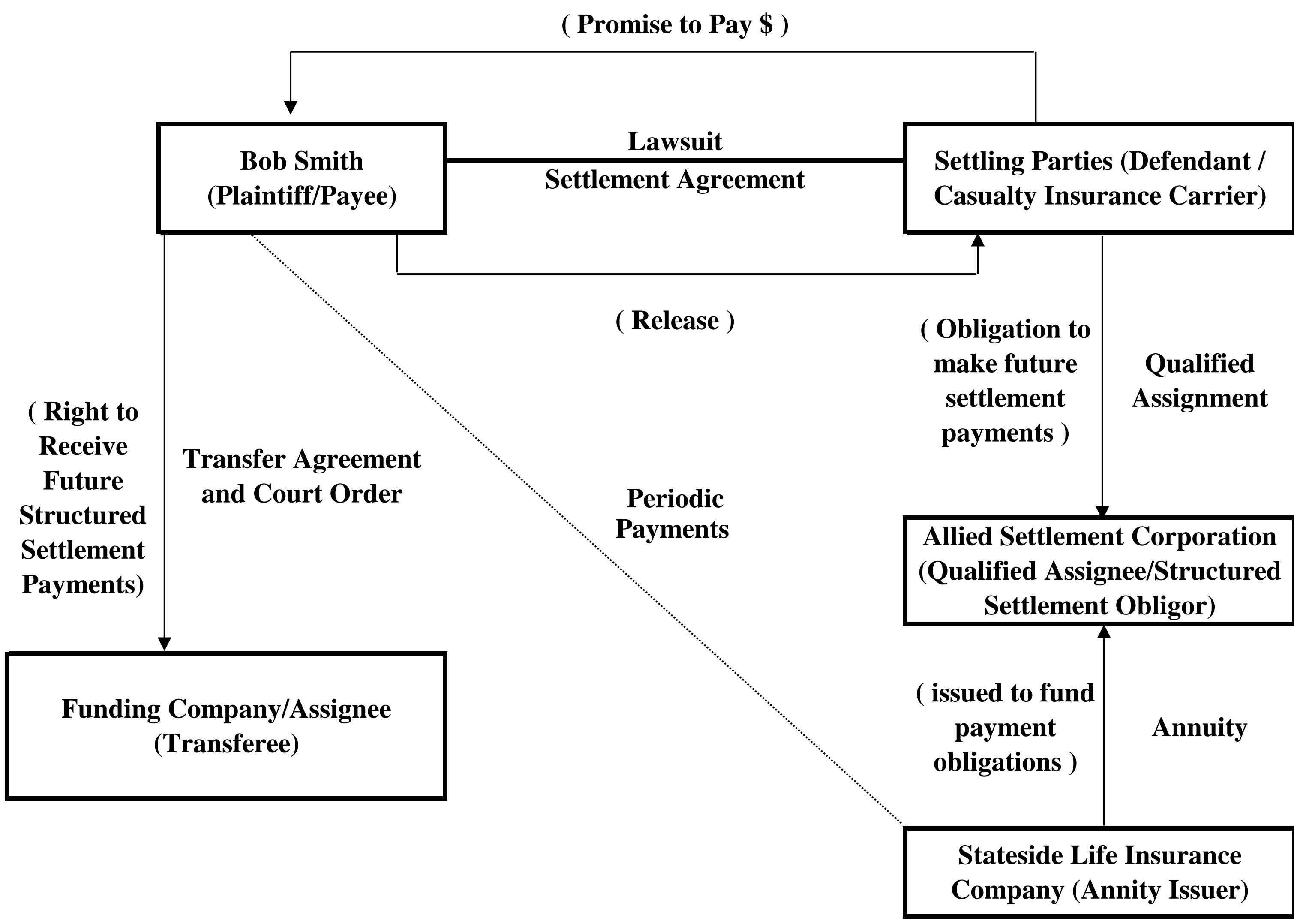
Assignment
Periodic
Payments
Allied Settlement Corporation
(Qualified Assignee/Structured
Settlement Obligor)
(issued to fund
payment
obligations)
Annuity
Stateside Life Insurance
Company (Annity Issuer)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Settlement Agreement
Settling Parties (Defendant /
Casualty Insurance Carrier)
(Release)
(Obligation to
make future
settlement
payments)
Qualified
Assignment
(Right to
Receive
Future
Structured
Settlement
Payments)
Transfer Agreement
and Court Order
Periodic
Payments
Allied Settlement Corporation
(Qualified Assignee/Structured
Settlement Obligor)
Funding Company/Assignee
(Transferee)
(issued to fund
payment
obligations)
Annuity
Stateside Life Insurance
Company (Annity Issuer)

Structured Settlements – Tax Implications
Kevin J. Marchand, CPA

All structured settlements have a common element which is the “time value of money”. A dollar today is just not the same as a dollar a year from now. This computation of the value of money gets substantially more difficult when income tax is included as a factor.

Awards for personal physical injuries and sickness can be excluded from income and taxes would not necessarily be a factor to consider in dealing with the structured settlement. However, many awards are not for physical injuries such as a wrongful employment discharge. Even physical injury awards may have a taxable component built in such as interest or punitive damages. In these cases, tax law will be important in determining adequate levels of liquidity for the injured party.

On New Year’s Eve of 2013, Congress spent their evening changing the tax laws and at the same time altered how we should look at a structured settlement. Many of the tax law changes focused on the “high income household”. The typical claimant may not think of themselves as being a member of a high income household but for at least one year that could become very much a reality. Periodic payments can help to reduce the tax impact on individuals who suddenly find themselves in such a household.

The top tax bracket has increased from 35% to 39.6% for single individuals with approximately $400,000 of taxable income and married couples filing jointly with taxable income of approximately $450,000. This particular tax change is easy to see and compute but many of the other changes are not so easy to follow.

The effective tax rate is increased above the 39.6% when the individuals itemized deductions and their personal exemptions are phased out. The elimination of the tax benefit starts when adjusted gross income passes the $250,000 - $300,000 range. The change in itemized deductions can add about 1% point to the top tax bracket. The loss of personal exemptions can add another point per exemption to your true tax rate. Capital gain tax rates have a new top bracket of 20%.

There are also tax law changes that take effect in 2013 as a result of the Affordable Care Act (Obamacare). There is an additional Medicare tax bump of 0.9% when single individuals have earned income in excess of $200,000 or when a married couple has earned income in excess of $250,000. An additional Medicare tax of 3.8% will be imposed on net investment income (capital gains, interest, dividends, passive rents, and royalties) of filers with an adjusted gross income of $200,000 single or $250,000 for married individuals filing jointly.

Individuals who find themselves in the alternative minimum tax bracket have additional problems to consider as that effective tax bracket can be 6 – 7 points higher due to these changes.

STRUCTURED SETTLEMENT TRANSFERS

Presented by
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BACKGROUND

- EXECUTIVE DIRECTOR/GENERAL COUNSEL OF NATIONAL ASSOCIATION OF SETTLEMENT PURCHASERS (NASP) (2002 TO THE PRESENT)
- FORMER GENERAL COUNSEL OF FUNDING COMPANY (1997-2001)
- ACTIVE WORKING ON STRUCTURED SETTLEMENT TRANSFERS AS A LAWYER SINCE 1992

BACKGROUND

- ACTIVE IN DRAFTING, ENACTING STATE STRUCTURED SETTLEMENT TRANSFER STATUTES AND 26 USC 5891
- WORKED ON LEGISLATION AT NCOIL, NAIC, CONGRESS, STATE LEGISLATURES
- TESTIFED BEFORE NUMEROUS STATE LEGISLATIVE COMMITTEES RELATIVE TO STRUCTURED SETTLEMENT TRANSFER STATUTES
- HANDLED 600 TO 800 TRANSFERS IN 13 YEARS, IN MULTIPLE JURISDICTIONS

HISTORY OF TRANSFER STATUTES

- Prior to 1998, no structured settlement transfers were court-approved
- First transfer statute was in Illinois in 1998
- Pre-1998, transactions were completed as arms length contracts between the Payee and the Funding Company

Issues with Non Court-Approved Transfers

- No regulation of the market
- Plethora of post-closing litigation
  - Diversions
  - Garnishments
  - Anti-assignment language
  - Security interests in all payments
  - Limited future liquidity options for Payees, Transferees, and Assignees

Issues with Non Court-Approved Transfers (continued)

- Obligors/issuers reacted inconsistently to transactions
  - Some were cooperative, meaning Payees would have liquidity options and costs were reasonable
  - Others were resistant and would flatly refuse to acknowledge or cooperate in connection with such transactions
  - Created uncertainty, inconsistency, and was bad for Payees, Transferees, Issuers/Obligors

Issues with Non Court-Approved Transfers (continued)

- Uncertain tax consequences
- Structured settlement primary market participants became concerned about the impact of the secondary market on the primary market

EARLY TRANSFER STATUTE ISSUES

- Issuer/Obligor “Veto Power”
- “Imminent financial hardship” of Payee standard
- Multi-jurisdictional compliance
- Extraterritorial reach of statutes
- Front-end disclosures (Minnesota, Massachusetts)

THESE CONCEPTS WERE, FOR THE MOST PART, REJECTED BY STATE LEGISLATURES OR MARKET PARTICIPANTS

NCOIL MODEL STRUCTURED SETTLEMENT TRANSFER STATUTE

- 2000 National Conference of Insurance Legislators passed its initial Model Structured Settlement Transfer Statute
  - Fierce debate between the Primary and Secondary Market
  - Key issues and arguments
    - Front-end disclosure
    - Standard for approval
    - No "Insurance Veto Power"
    - Tax impact of transfers
    - Regulation of Secondary Market desired

The Primary/Secondary Market Compromise

- Late 2000 – Interlocking State and Federal Legislative Scheme

- ALL transfers would have to be court-approved in order to be effective

The Primary/Secondary Market Compromise (continued)

- 26 USC 5891 (Enacted by Congress in January of 2002)
  - Imposes 40% excise tax on structured settlement transfers that were not court-approved
  - Court-approved transactions (approved in a "qualified order" under "Applicable State Statute") exempt from excise tax
  - Resolved tax concerns for Issuers/Obligors

The Primary/Secondary Market Compromise (continued)

- Created a need to enact State Transfer Statutes
- NCOIL Model Revised
- State Transfer Statute Requirements
  - Disclosures to be provided to Payees
  - Notice to “Interested Parties”
  - Requires a hearing and court approval

The Primary/Secondary Market Compromise (continued)

- Required findings in court order
  - Transfer is in Payee's "best interest"
  - Payee admonished to seek independent professional advice
  - Transfer does not contravene court order or statute

- Interested Parties, including Issuers/Obligors have opportunity to oppose transfers in Court

The Primary/Secondary Market Compromise (continued)

- Indemnity obligations imposed on Transferee
- Issuers/obligors cannot be compelled to split payments
- Procedures must be adopted for life-contingent payment streams

VERMONT TRANSFER STATUTE

- § 2480aa – Legislative Intent Statement
- NASP opposed this statement because it includes language which is inaccurate or unnecessarily antagonistic toward the Secondary Market and Payees

VERMONT TRANSFER STATUTE

(Legislative intent statement)

- Implies that most structured settlements are court-approved. NOT TRUE.
- Implies that a transfer of structured settlement payments “sets aside” a structured settlement. NOT TRUE.
- Not included in other versions of the bill.
- Can be used to hurt payees who need liquidity options.

VERMONT TRANSFER STATUTE

(Payee's right to cancel)

- Vermont Statute allows the payee to cancel up until the date the court enters an order approving the transfer.
- NASP proposed that the payee could transfer until application was filed.

VERMONT TRANSFER STATUTE
(Payee's right to cancel)

- Transferee must incur all costs to file application, retain counsel, schedule and attend hearing, pay for Payee's IPA and Payee can still cancel at last minute.
- Increased risk to Transferee, which costs are passed along to Payees.
- Enhanced prospects of litigation and shenanigans in the market.

VERMONT TRANSFER STATUTE
(Independent professional advice)

- Court must “expressly find” that
  - Payee as been advised to seek IPA
  - That the Payee has in fact reduced such advice; OR
  - That IPA is “unnecessary” for good cause shown.
- If Payee has chosen not to get IPA, Court may continue the hearing and require Payee to get IPA.
- Court may require the Transferee to pay up to $1,500 for IPA

VERMONT TRANSFER STATUTE

(Documents to be filed under seal)

- Transferee must file a “certification” from an IPA; OR
- A “written request” from the payee that the court determine such advice is “unnecessary.”

- If a Payee does not wish to consult with IPA, then the Payee must ask “request” the court to determine that such advice is unnecessary.

DISCOUNT RATES

- Discount rate applied to future payment stream determines the purchase price to Payee

- Primary elements that determine discount rates
  - Cost of funds
  - Timing of payments
  - Creditworthiness of Issuer/Structured Settlement Obligor

DISCOUNT RATES

- Other factors that impact discount rates
  - Buying fixed rate, long-term deals with short-term credit facilities -- funds borrowed at variable rates
  - General economic conditions
  - Size of the transaction in terms of funding amount
  - Alternative investment yields
  - Competition
  - Likelihood of court approval
  - Transaction documents

DISCOUNT RATES

- Deal expenses – attorneys fees, court costs, administrative fees
- Marketing costs
- General overhead
- Guaranteed v. life-contingent payments
- Servicing costs
- Servicing arrangements
- Esoteric nature of assets
- Profit expectations of Transferee

DISCOUNT RATES

- Unique Risks
  - Issuer administrative issues
  - Executive Life of New York Receivership/Rehabilitation
  - Reliance, Confederation, Monarch Life failures
  - Interference with pending contracts
  - Competing claims – tax, child support, marital property issues

DISCOUNT RATES -- EXAMPLES

- What's the best deal for the Payee?
  - Selling more payments at a lower discount rate?
  - Selling fewer payments at a higher discount rate?
  - Monthlies v. lump sums
  - Payments that start immediately v. payments that start far in the future
  - Payee's circumstances

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

- Acceptance of Structured Settlement Myths
  - Myth: All payees sell their structured settlement payments.
  - Truth: A small percentage of those receiving structured settlement payments have a need for liquidity

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

– Myth: Payees who assign their structured settlement payments for a lump sum are foolish and ignorant.

– Truth: Payees know their financial and personal situation better than anyone else. They may be unsophisticated, but they understand what they are getting and what they are giving up and typically pursue a transfer as last resort.

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

– Myth: A robust secondary market hurts the primary market for structured settlements

– Truth: Having a liquidity options makes structured settlements more valuable and more desirable to Payees.

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

– Myth: All individuals who are receiving structured settlements are seriously injured, unable to work, and 100% dependent on their structured settlements to survive

– Truth: Structured settlements are used to settle all kinds of cases – wrongful death cases, inherited structures, beneficiaries. Payees recover from their injuries. People's circumstances change.

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

- Myth: Payees should get low-interest loans.

- Truth: Secured loans must be court-approved. Banks do not go to court to get permission to loan money. Payees often have spotty credit records. Consumer loans can be repaid at any time.

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

- Hostility toward the business, Payees, and lawyers
- Interference with pending contracts
- The “mobile” Payee

MISCELLANEOUS, MYTHS PET PEEVES & CURRENT ISSUES

- Amending/revising orders after the fact
- Issuer/Obligor transaction impediments and rigid parameters
- Rigid “rules and guidelines” for evaluating transfers
- Form orders

THE GOLDEN RULE

- Intent of the Transfer Statute was to:
  - Insure that ALL Payees had liquidity options
  - Insure that Payees had the information to make informed decisions
  - Protect Payees from overreaching

THE GOLDEN RULE

- Provide Payees the ability to make decisions about their finances and lives
- Provide a gatekeeper

- THE FOCUS OF THE TRANSFER STATUTE AND THE TRANSFER HEARING SHOULD BE ON THE PAYEE

THE END