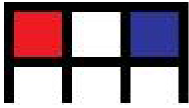

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Most that are familiar with Structured Settlements are aware of the benefits associated with them. To name a few: all payments are exempt from income taxes. Tremendous flexibility of how payments can be set up. Payments can be arranged to meet a myriad of anticipated future financial needs such as college funding, retirement income and periodic medical treatments. The liability for making the payments is "assigned" or transferred to a life insurance company. Payments can be set up on a "joint and survivor" basis in cases where the spouse also has a claim. Plaintiff's counsel can structure his or her fees to defer the tax liability into the future.

All of these benefits beg the question, "Why isn't a structured settlement the first choice in the vast majority physical injury and worker's compensation cases?" We think that it's because there are some misconceptions surrounding structured settlements, which we will address in this article.

Misconception #1. *A structured settlement is only applicable in very large cases.*

While it is our opinion that a person receiving a very large settlement is well advised to structure at least some of the money, a structured settlement can be very beneficial in even small cases. (Please note that all life insurance companies who offer structures have minimum premium amounts, most are $10,000 and a few are even as low as $5,000.)

Let's say, for example, that a five year-old male was injured in an auto accident and will be receiving a settlement of $15,000. A structure would pay him about $7,760 annually or $660 monthly, for four years, beginning the August after he turns eighteen. This won't put him through Harvard, but it could certainly defray some education related expenses. If he chose not to pursue further education after high school those funds would be available to help him get himself established as an independent entity.

Another example would be a 40 year-old woman who is receiving $20,000 to settle an injury claim. A structure could be placed which would pay her $315 a month, tax free, beginning at age 60 for life with a minimum guarantee of 20 years. Again, this is not a monumental amount, but it could certainly make her retirement years more comfortable. Also, using a structure she could be paid a single lump sum at age 60 of about $52,000.

While none of these are "life changing" amounts of money, they could be attractive alternatives for consideration. That is, however, only if an individual (or his or her parent or guardian) is exposed to various structured settlement scenarios. We believe that a structured settlement should be presented in nearly every case involving a minor and in any case involving adults in which the individual needs the security of guaranteed payments.

Misconception #2. *Structured settlements are illiquid and this is a bad thing.*

The fact is that with a structured settlement, the life insurance company will only make payments to the annuitant in the manner that was chosen at the time the annuity was purchased. There are no "ifs,

ands or buts" about this. Further, structured settlements cannot be used as collateral for loans. This is, clearly, almost a textbook case of illiquidity, but is that a bad thing?

It certainly could be a bad thing if 100% of a settlement was placed in a structure without any needs analysis. The financial needs of individuals change over time. There is no single investment vehicle that can adequately provide for every unforeseen event while also providing a high degree of long-term financial certainty. Failing to provide claimants with some liquidity and financial flexibility could be a serious financial planning error. However, at Paul & Associates we believe that providing claimants with too much liquidity could be an even more serious error.

Physical injury cases often involve the need for ongoing medical care and/or long-term physical assistance. Everyone involved in the settlement planning process needs to be cognizant of this. Sadly, it is very common that lump sum settlements are spent frivolously or fall prey to financial predators. When this happens, and injury related needs arise, the only "safety net" is a publicly funded assistance program such as Medicare or Medicaid.

This is the reason that the Center for Medicare and Medicaid Services (CMS) has begun to require a review of all Workers Compensation settlements within certain parameters. The goal of CMS is to protect the financial integrity of Medicare and Medicaid. In a ten-year study they estimated that the public programs spent roughly $45 billion on injury related medical needs for individuals who had received a physical injury settlement. The CMS belief is that appropriate planning and the use of structured settlements can significantly reduce the financial burden on governments. They have the legal authority to extend their review to all physical injury settlements.

We believe in a needs based approach to settlement planning. We are certain that there is no "one size fits all" investment solution for anyone, much less those who have had serious injuries and face an uncertain future. We believe that it is incumbent upon us and everyone involved in the settlement planning process to provide the injured party with as much financial certainty and flexibility as is appropriate.

To that end we not only use structured settlements extensively, but we also use various kinds of settlement trusts. The value of trusts is that they provide a high level of financial protection and, at the same time, can be designed to create varying levels of liquidity. Additionally, trust assets can be invested in stocks and bonds or a combination of both. Trusts do not have the tax advantages of a structure and, consequently, it is not uncommon to use both a trust and a structure for the same individual.

Misconception #3. *Structured settlements have a low rate of return.*

First, it is important to compare apples to apples, which is difficult at best. A structured settlement is a fixed-rate, tax-free investment vehicle that is guaranteed by a life insurance company. There are no securities or bank instruments that can compare to this, particularly if the structure is set up with a guaranteed lifetime income.

Other kinds of annuities can provide guaranteed lifetime income, but the interest earned is fully taxable at the time it is paid. Common and preferred stocks can pay dividends indefinitely, but they are not guaranteed and dividends are, under most circumstances, fully taxable. Bonds pay interest, but only until they mature and the principal is repaid. Plus, only Municipal Bonds pay interest which is tax exempt and that, in many cases, is only exempt from federal taxes. Additionally, with the exception of

deferred annuities, all of these instruments require some investment management skill and/or a fee paid to a third party manager.

Consequently, in our judgment, there really is not any kind of a "straight up" comparison that can be made between structures and any kind of other investment instrument. With that said, one could loosely compare the returns between a "period certain" structure and a tax-exempt municipal bond. According to the Wall Street Journal as of January 12, 2007, tax-exempt bonds with maturities of between 12 and 22 years were averaging returns of 4.12%. A 12-year period certain structure at the same time had a 4.92% internal rate of return and a 22-year period certain was 5.22%.

Rarely, however, does the structure candidate do much analysis comparing the structure and other instruments. Commonly they are investment novices and have been convinced by a third party that, regardless of what the structure is promising, they can, "do better on their own." Often a stockbroker or financial planner has told them that a particular investment manager or mutual fund complex has a "great track record." They have been shown an illustration using past returns projected into the future that makes the structure look sick.

A couple of points in this regard. First, only about 10% of investment managers, whether associated with mutual funds or not, match or beat their respective market benchmark in any given year. More significantly, the percentages shrink dramatically when you try to find investment managers who have matched or beaten their benchmark average for any number of consecutive years. It is not that these folks are not smart or good at what they do, it is that meeting or exceeding market returns is a daunting task that, literally, only a handful of managers are able to do with any consistency.

Second, invariably when investment sales people present mutual funds or other managed portfolios they speak in terms of "average returns" over given periods of time. (They, of course, always clearly point out, as required by law, that "Past results are no indication of future returns.") The illustrations they use depict the average returns in linear fashion, year in and year out. The results will blow away the annual cash flows from a structure and can be very appealing to an investment novice. The reality is that investment returns, regardless of how aggressive or conservative a portfolio is, occur in totally random fashion. It would be nearly impossible to calculate the probability of any investment manager duplicating a contiguous set of annual returns at any point in the future. There are just too many variables.

It is interesting to note that there is software available that actually does these kinds of calculations. These programs are referred to as Monte Carlo Simulations. You plug in a desired percentage allocation of stocks, bonds and cash along with a desired rate of return, cash withdrawals and time frame. The software can do as many as 10,000 random trials in less than a minute. The program tells you how often the expected result will be achieved. It is a fascinating exercise and opens the eyes of both experienced and novice investors.

Misconception #4. *Structured settlements are complicated.*

No question that there are many "i's" to be dotted and "t's" to be crossed with a structure, not to mention the initial presentation of the concept to a claimant who may be very financially unsophisticated. This is where a relationship with an experienced, knowledgeable and reliable structured settlement professional is critical. Most of us have seen the TV ad for a financial services company where a physician is on the phone explaining to his patient (who is at home in his kitchen)

how to make the initial incision in his chest. The patient picks up a paring knife, looks at his chest and says, “Shouldn’t you be doing this?”

It is no different with structured settlements. At Paul & Associates we take great care to ensure that everything is done precisely and professionally. That is what we do best. This allows you to spend more time doing what you do best.

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