Structured Settlements: A Buyer’s Guide

Learn more about court-ordered structured settlement transfers, what makes them attractive and how they can help you reach your financial goals for the future.
WHAT IS A STRUCTURED SETTLEMENT?

For the longest time, compensation claims for injuries, liability and malpractice were resolved through lump sum payments awarded by courts and juries. But, as the dollar amount of these awards began to rise dramatically in the 1970s, courts began awarding structured settlements that were intended to protect the interests of both the injured plaintiff and the paying defendant.

These court-approved agreements instead allowed the compensation award to be paid out in instalments over an extended period of time. The defendant’s liability insurer typically assigns its obligation to another insurer (known as an obligor), which in turn purchases an annuity from another insurer (often an affiliate of the obligor) to provide guaranteed payments to the claimant on a periodic basis, whether monthly, quarterly, annually, or some other specified way, over the specified time period. Certain tax advantages available under the Internal Revenue Code if the transaction is handled as specified explain why the parties engage each other as they do.

By relieving the crushing financial burden that a lump sum cash award would immediately create, structured settlements help the paying party avoid a calamity of its own (like bankruptcy) that could also affect the ability of the claimant to collect the judgment award, while providing a secure income stream to the claimant.

Signed into law in 1982, the Periodic Payment Settlement Act protected the plaintiff from bankruptcy and provided a guaranteed income flow for the injured party.

While intended to provide the injured party a guaranteed, long-term income flow designed to help pay for future medical care or replace income lost due to an inability to work, the fact that structured settlement payments are fixed in terms of both timing and amount means injured parties face the risk of changing personal and other surrounding conditions that those payments may not be available to meet or enough to satisfy when the payments do come due.
How are structured settlements funded?

Typically, liability insurers assign their payment obligation to an insurer that covers casualty risks (an obligor, a term mentioned earlier), which, in turn, purchases an annuity – the funding vehicle – from a life insurance company, at a cost which is a fraction of the total cost of the judgment award that is to be paid over time.

These annuities follow payment schedules that automatically fund periodic payments to the claimants, who are named as the “annuitant” or “payee” under the annuity. Payments continue for an agreed period of time, which can be any length of time, even the annuitant’s lifetime.

Annuities provide tax advantages to the parties obligated to pay the claimant while at the same time serving as a vehicle that protects the claimant’s expectation of being paid.

Can structured settlement payments be sold?

Provided the necessary conditions are satisfied, yes. The fact that many structured settlement payments can be sold recognizes that the idea that the injured party receiving guaranteed periodic payments in specific amounts at specific times may have sounded like the perfect solution at first but instead has proven frustrating and inconvenient as times. Needs, and conditions have changed, probably in ways the injured party didn’t predict, from needing more immediately-available proceeds to pay debt, purchase a home, send a child to college, or start a new business when credit and funds aren’t otherwise available.

However, not all types of structured settlement payments can be sold. For example, worker’s compensation payments cannot be sold in many U.S. states. Structured settlement protection statutes have been enacted in nearly every U.S. state, explaining what conditions must be satisfied before a proposed structured settlement payment sale can be completed. Principal among those conditions are the requirement that specific disclosures be given to the seller and that a court of competent jurisdiction review the proposed transaction and determine that it is in the payee’s best interest that the proposed sale be approved.
How does someone sell structured settlement payments?

First, let’s address a common misconception: the seller only sells his payment rights, not the annuity itself.

If you’re wondering why and if you’re wondering whether this should be a concern, there is a simple explanation that both answers the question and completely addresses the concern: the seller owns the payment rights but not the annuity. The obligor we mentioned earlier owns the annuity and does not sell it because doing so would cause a loss of favourable tax treatment the obligor enjoys.

So, how is the concern addressed? Here’s how: the obligor consents to the sale of the payments by the payee in addition to the court approving the transaction. In fact, part of what leads the court to approve the proposed transaction – in addition to finding that it is in the payee’s best interest that the payee conduct the proposed sale – is that the annuity issuer does not oppose the sale, and either does the annuity owner (again, the obligor), each of which receives notice as required by applicable law that the payee has entered into a transaction to sell structured settlement payment rights.

Now that we have a better understanding of what the payee sells and how it happens, the payee still needs to find a buyer for this to happen. Generally, that will mean researching funding companies like Woodbridge that purchase structured settlement payments.

An annuitant could also decide to try to find a private buyer, someone just like you. However, someone who has not been a pioneer in the factoring industry like Woodbridge and its affiliates and predecessor companies for the past 20 years wouldn’t likely know all of the steps and requirements that must be followed to properly and correctly conduct a structured settlement payment transfer.

When the payee sells structured settlement payments – regardless whether some or all, in whole or part – the seller receives a lump sum payment that is less than the value of the payments being sold to you. What the seller receives is a portion of the present-day discounted value of those payments (accounting for transactional fees and costs and revenue), and that discount, in effect, is what allows there to be a yield to a buyer like you, in the form of those future annuity payments in exchange for the purchase price you pay for that payment stream.
How is present day value determined?

If the idea of present value isn’t something you’re already familiar with, then the easiest way to understand this is to think of it like a loan, but in reverse.

Let’s walk you through it.

Say you were to borrow $100,000.00 and repay it over 20 years at an interest rate of 5.00%. When you repay that loan according to a normal repayment schedule, you would end up making 240 monthly payments of $653.84 each to the lender, totalling $156,921.60.

When buying a structured settlement, you work backwards.

You already know the payment dates and amounts, so all that’s left to determine is the purchase price it takes to lead to those payments on those dates. It’s like figuring out the original loan amount, based on the interest rate desired. For a purchase price of $100,000.00, those payments on those dates total $156,921.60, which represents a 5.000% effective annual yield on that $100,000.00 purchase price over that 20-year payment period.

For investors looking for something safer and more predictable than what the stock ticker shows, purchasing structured settlement payments offers steady, virtually risk-free growth in a predictable way.

WHAT ARE THE BENEFITS TO BUYING STRUCTURED SETTLEMENT PAYMENTS?

Predictability

Structured settlement payments offer certainty that the stock market and its daily ups and downs simply cannot provide, thanks to payment amounts, dates, and terms specified in writing, no subject to shifting consumer trends or stock market volatility.
Protection

In addition to the underlying transaction having to satisfy applicable structured settlement protection statutes and being memorialized by means of court order designating you or your designee as the new payee, your rights to receive these payments, even in the extraordinary case of insurer insolvency, are backed by state insurance guaranty funds.

If you are thinking about purchasing structured settlement payment rights, seek the counsel of a trusted financial advisor who can look at your total financial picture and help determine whether or not it can be a good choice for you & your objectives, particularly if your objectives lean towards higher predictability and lower risk, attractive returns, and balance.

Attractive yields in comparison to alternative investments

Since the recent recession, interest rates on FDIC-insured one-year certificates of deposit and money market accounts have plummeted, in many cases to less than 1% per year, and there is no telling how long rates will remain at these historically low levels. In contrast, purchasing a structured settlement annuity payment stream through Woodbridge offers an effective pre-tax annual yield of between 4% and 7%, depending on payment terms, dates, amounts, and conditions and provides a reliable stream of income or a generous lump sum payout at a specified point in time.

Payouts to fit your financial goals

What helps make structured settlements a good option for so many people is the wide variety of payment dates, amounts, and terms available. For instance, a young couple might choose to purchase a structured settlement payment stream that provides a lump sum just when it comes time to pay tuition, room & board when their baby grows up and heads to college. Or, a retired couple might choose payment terms that provide an annual yield and income stream to supplement pensions – or offset the fact they don’t collect a pension.
HOW DO STRUCTURED SETTLEMENTS ADDRESS SAFETY ISSUES?

During the past 20 years, nearly every U.S. state has enacted legislation the outcome of which has been to better ensure that structured settlement payments not previously sold but bought by third parties would be paid to and received by those buyers.

When you buy structured settlement annuity payments, you’re not purchasing the annuity itself. Instead, you’re purchasing the payment rights.

If it seems unusual that you don’t become the owner of the annuity itself, you should know that the annuity contract’s ownership does not change because the entity that owns it (typically an insurance company) receives certain tax benefits that could be lost if the ownership changes. Not even the original payee ever owns the annuity. But, the payment rights are specifically made payable to you, by court-ordered direction, and both the annuity issuer and annuity owner are required to comply with the payment direction in the court order that specifies that you are to receive the payments that you purchase.

You may also be wondering “Why a court order?” Besides providing added comfort and verification that you are recognized as the owner and recipient of the payments that you contract to purchase, structured settlement payment transfers in most U.S. states are subject to state laws that require that a court review and approve the transaction before it can be completed, and the court order demonstrates that applicable state law requirements have been satisfied.

Structured settlement annuity payments are paid through annuities issued by some of the nation’s largest, most highly-rated insurers, based on their claims paying and/or financial strength ratings assigned by A.M. Best, Moody’s, or S&P.

More important, perhaps, is the fact that those insurers are also highly regulated by the state insurance regulatory authority of each and every state in which they do business, which means the following applies to those insurers:

- They are required to file detailed financial statements annually to maintain licensure.
- They are subject to periodic financial condition, operations review, and statutory and regulatory compliance audits.
• They are obligated to maintain minimum capital and surplus requirements and set aside reserves to satisfy future commitments that structured settlement-based annuity payments represent.

• State laws nationwide strictly mandate and regulate how they can invest capital that must be maintained on account.

Should an insurer’s continuing operations or solvency become jeopardized for any reason, state insurance commissioners are authorized by applicable law to take immediate action to protect the interest of policyholders and payees, and to require orderly liquidation in worst-case situations, in which case structured settlement annuities are among the class of payment obligations that receive priority payment status.

ARE THERE RISKS INVOLVED?

In a word, yes. Most everything in life involves some degree of risk. Before purchasing structured settlement payments, you should be aware of the following:

• Payout Risks
  You are relying on the annuity issuer to exist, be capable of making, and actually issue the payments that you purchase. If a servicer receives those payments on your behalf, you are additionally relying on that third party to exist and honor its commitments at the time each corresponding payment comes due.

• No Financial Liquidity
  You will have no immediate access to any portion of any payment you purchase until its respective due date. This may be particularly relevant to you if you anticipate having future liquidity needs, whether on an emergency basis or otherwise.

• Fixed Payment Dates, Amounts, and Returns on Purchase
  Returns, effective rates of return, payment dates, and payment amounts are fixed and non-variable at the time of purchase. If interest rates increase in the future, then you may find that what was to you an attractive return schedule at the time you make your purchase is not as attractive in the future.
• **Not FDIC Insured**
  Unlike a certificate of deposit or similar instrument, structured settlement annuity payments are not FDIC insured or otherwise insured or backed by the federal government.

**WHAT ARE THE STEPS TO COMPLETING A PURCHASE?**

Whether you conduct your purchase personally or through a financial advisor, Woodbridge Structured Funding account executives will be able to guide you through each of the following steps in the process:

**Step #1:**
**Identify an available payment stream that suits your financial goals.**
Review our daily inventory schedule, which includes short-term, medium-term, and long-term payment streams, from single lump sums and periodic payments to monthly payment streams and combinations.

**Step #2:**
**Verify availability and request paperwork to initiate the purchase process.**
Call or e-mail Woodbridge to verify availability of your preferred payment stream. If your preferred payment stream is available, complete and submit to us our buyer information document so we can open a purchaser file for you (if you have not already done so) and reserve that payment stream for you and remove it from our active inventory.

**Step #3:**
**Submit an offer to purchase your preferred payment stream.**
Complete and submit to us our Master Assignment and Assumption Agreement (MA) if you have not already done so, and complete the Offer Sheet (OS) we generate based on your offer to purchase your preferred payment stream. The Offer Sheet must be completed & returned to us within 48 hours with the required funds (either a 10% deposit or full purchase price, as you will be informed when you indicate your interest in the related payment stream), or the payment stream will be returned to our active, available inventory.

The MA is the master agreement that governs all of your structured settlement payment purchases through Woodbridge, so you only need to execute one of those. On the other hand, you will need to complete a separate OS with respect to each payment
stream that you seek to purchase. While you are welcomed to make purchases using qualified IRA funds, please be sure corresponding funds are on deposit with your IRA custodian prior to initiating your purchase. You should review the MA and each OS with independent tax, legal, and financial advisors.

Step #4:
Note the hearing date for the related proposed payment sale by the seller.
You may recall that this guide earlier described the process by which a structured settlement recipient sells his or her structured settlement annuity payments. The payments you offer to purchase can only be assigned to you if a court of competent jurisdiction determines that it is in the best interest of the annuitant or payee to conduct the proposed sale.

You will be advised of the court date of that hearing (which you are not required to attend). We must receive the full purchase price for the corresponding payment stream in escrow at least 30 days prior to that date.

In the event the court rejects and denies the proposed transfer and the petition to authorize that transaction is not re-filed, your proposed purchase of that payment stream is terminated and all monies held in escrow representing the purchase price you have paid to acquire that payment stream will be promptly refunded to you.

Step #5:
Receive & review Closing Book after the payment sale is approved in court.
Between 30 to 60 days after the sale is approved in court, you will receive a Closing Book containing supporting documents and information relevant to your purchase, including but not limited to a copy of the court order and filings leading to that, as well as documentation evidencing the annuity issuer’s acknowledgment to abide by the terms of the court order.

Step #6:
Escrow breakage and release of funds.
Once you’ve completed final review of the Closing Book and signed & returned to us the final funding instructions, escrow will close and your purchase will be finalized, at which time your purchase price funds will be released to us.
The entire process can take up to 180 days to complete. Upon the annuity issuer receiving and acknowledging a copy of the court order approving the sale, you will begin receiving scheduled payments as the court order describes.

ADDITIONAL CONSIDERATIONS

Are there any hidden fees or costs to complete my purchase?

No. Woodbridge does not assess any additional fees or costs to you to complete your purchase. That said, the final purchase price amount may vary from the amount contained in the OS because the purchase price set forth in the OS is based on a projected funding date. The actual funding date may be earlier or later depending on case-specific conditions, which would affect the actual, final purchase price, because that purchase price is calculated using the agreed effective rate as of the actual funding date.

How will payments be made?

If you have purchased a structured settlement payment stream that provides periodic payments, then those monies will be distributed by check or electronically transferred into an account that you specify.

Each insurance company has enacted its own policies and procedures for handling payment distributions to structured settlement payment assignees and purchasers. You are welcomed to contact the annuity issuer directly to inquire as to its particular policies and procedures.

How are structured settlement payments that I purchase taxed?

The annual growth of your structured settlement will be taxed as ordinary income each year.
What happens if payments that I purchase remain to be paid when I die?

Typically, the court order will specify how the annuity issuer will issue purchased payments following the death of the purchaser (assignee).

With respect to a buyer who makes a purchase in his or her individual name, most annuity issuers will issue such payments to the estate of the buyer as and when those come due.

Purchases made by joint tenants with right of survivorship specifically set forth in the court order can expect to see payments continue to be paid to the surviving purchaser.

With respect to buyers who make their purchases through a vehicle (such as an IRA or trust), most annuity issuers will continue to issue payments to that vehicle, and it is up to the custodian of the vehicle to further handle those payments in ways consistent with the governing terms of the vehicle and applicable law.

What if I need to sell in the future the payments that I purchase?

Structured settlement annuity payment streams are non-liquid in nature, and the payments cannot be accelerated, increased or deferred.

If you decide to sell, then the lump sum payment you would receive from a buyer will be only a percentage of the future value of those payments.

CONCLUSION

Before you purchase any structured settlement payment stream, as your advisor I recommend that you consult and carefully review with your tax, financial, and legal advisors your proposed purchase, to determine whether the proposed transaction is appropriate for you, as well as to determine the most appropriate method for taking title to any such purchased assets, so that you can address all relevant concerns.