Common Misconceptions About Structured Settlements

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Misconception 1:

The choice to structure a settlement, in whole or in part, is about comparing rates of return.

The relative rate of investment return is not, respectfully, the first question that should be addressed when considering investment options in reference to a settlement offer for compensatory damages. Rather, the first question to be addressed is how well (and securely) the amount offered meets or approximates the needs of the injured person going forward.

The best way to test that is to obtain a structured settlement cost (which is produced, as a means of valuation, without obligation and free of charge) in reference to those needs (as stated in a future care cost analysis, for example) and then comparing that to the amount offered. Given that settlement offers are often limited (by legislation or contract, among other things), the next step would be to determine how much incremental income (produced by a structured settlement or another form of suitable income producing investment) the amount offered will produce, again in light of those needs.

Given that these needs are likely longer term and somewhat fixed, the security of the investment is also an important consideration. In particular, the injured often have limited or no worklife expectancy, making their risk tolerance virtually nil; that is, should they lose the investment of their settlement funds, they do not, generally, have the ability to work and recover the amount lost (as would be the case for most of us). And if this investment fund is compromised, because of capricious spending that easy access makes possible, no rate of return consideration can save them from early dissipation and, quite possibly, reliance on social assistance.

It should also be pointed out that the rates of return illustrated for variable, market-based investment products are almost always inappropriate in this context in that returns for these products are only achieved when **all of the periodic income (coupon and/or dividend payments) is re-invested**. The "total return" will never be realized by an investor that must use investment income to cover ongoing periodic expenses such as the cost of care. It is therefore misleading to compare these returns to a **structured settlement (which provides guaranteed, periodic monthly income)**.

Quite simply, nothing exceeds the financial security offered by a structured settlement. It is, by far, the best protection against early dissipation (and by reference to one commonly cited study, 90 percent of all lump sum settlements are completely spent within 5 years). And because a structured settlement offers rates of return that are net of tax and without "loads," it is also, by far, the best investment option by reference to the criterion of greatest "real" rate of return for the least amount of risk.

Misconception 2:

The rates of return on structured settlements are very low.

There is a gross misconception that structured settlements offer rates of return that are well below market standards. In fact, the rates of return on structured settlements are very much in step with the rates offered by other **fixed income products**; for example, Canada Savings Bonds, which, like structured settlements, are guaranteed for and dependent on the term under consideration. However, unlike Canada Savings Bonds (and any other investment option, guaranteed or otherwise), structured settlements produce **returns that are net of income tax**. Consequently, they continue to offer, invariably, the best combination of the **greatest "real" rate of return for the least amount of risk**.

Again, the speculative rates of return illustrated for variable, market-based products are almost always inappropriate in that these returns are only achieved when **all investment income is re-invested, thereby leaving the recipient without any income by which to meet ongoing periodic needs**.

Below is a table setting out the income returns resulting from the purchase of a 10-year Redeemable Guaranteed Investment Certificate ("GIC"), a Non-Redeemable GIC and a structured settlement. Each assumes a term of 10 years, pays interest income monthly, returns the initial investment at the end of the term and was produced pursuant to interest rates in force as of March 27, 2012.

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Guaranteed Investment Certificate ("GIC") versus Structured Settlement			
Investment Features	***10-Year Redeemable GIC – Interest paid monthly***	***10-Year Non-Redeemable GIC – Interest paid monthly***	***10-Year Structured Settlement Annuity***
Investment Amount	$700,000.00	$700,000.00	$700,000.00
Yield	2.125%	2.375%	3.338%
Monthly Interest Paid	$1,239.58	$1,385.42	$1,947.34
Annual Interest Paid	$14,875.00	$16,625.00	$23,368.08
Tax Payable (25% rate)	$3,673.38	$4,156.25	$0.00
Net Annual Interest Received	$11,201.62	$12,468.75	$23,368.08
Total Net Interest Received	**$112,016.20**	**$124,687.50**	**$233,680.80**
Return of Capital	$700,000.00	$700,000.00	$700,000.00
Total Payout	**$812,016.20**	**$824,687.50**	**$933,680.80**

Structure Advantage over 10 years (versus Redeemable GIC) = $121,664.60

Structure Advantage over 10 years (versus Non-Redeemable GIC) = $108,993.30

Misconception 3:

All structured settlements are for lifetime only.

As the foregoing contradicts, there also exists a widespread belief that structured settlements can only be placed for a client's lifetime. While a lifetime term of periodic payments may be considered necessary in cases involving persons under disability, that is not so for those considered competent. The composition of a structured settlement is really a function of the answers to the following seven (7) questions or variables, one of which is the term of the investment. Answer all seven questions and you have a structured settlement plan, with its own unique rate of return. Change the answer to one or any of the seven questions and you have another plan, again with its own unique rate of return.

1. amount to be invested;
2. term (i.e., how long the plan is to run);
3. commencement date of income (i.e., immediate or deferred);
4. frequency of payments (i.e., monthly, annual, etc.);
5. lump-sum payments, if any, and the timing of these;
6. level or indexed benefits;
7. guarantee period to secondary payee (beneficiary).

Anecdotally, today, our firm places more structured settlements for clients considered competent of the variety illustrated above than any other; that is, a plan with a fixed term and the entire investment amount returned at the end, net-of-tax and entirely guaranteed, both to the primary recipient and his secondary payee (beneficiary); that is, effectively a tax-free GIC.

Misconception 4:

A structured settlement is an all or nothing proposition.

A properly "structured" plan for the compensatory damages granted a competent client, generally, should include a modicum of investment in assets with some liquidity. To begin with, in most cases, there is a need for up-front cash to pay legal fees and relieve usurious debt (e.g., credit card debt). And going forward there may be a desire and, perhaps, a need for investment in instruments that accord instant access to cash or liquidity. How much goes into this sort of investment versus how much goes into a structured settlement is dependent on risk tolerance, measured by reference to, first and foremost, the likelihood of a client proceeding to access and dissipate, prematurely, the investment and, second, the likelihood that the investment will deliver on a promised return. As stated above, the injured population, given their often significant impaired life and worklife expectancies, has a much lower risk tolerance than the general population. Nonetheless, higher liquidity investments and investment in a structured settlement are not mutually exclusive. The issue is finding the correct balance between the two.

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Misconception 5:

A structured settlement should be considered only for settlement amounts in the range of $500,000 and up.

There exists a misconception that structured settlements should be considered only in reference to larger amounts. As stated above, our firm places many fixed term structured settlements (e.g., for a certain number of years or until a certain age), with the entire investment amount returned at the end, net-of-tax and entirely guaranteed both to the primary recipient and his or her secondary payee (beneficiary). These plans offer the same rates of return and protection from personal income tax and early dissipation as others and range up from about $50,000.00.

Summary

There is, clearly, a good deal to consider when comparing structured settlements with other investment options. In assessing the relative merits, the following questions might serve as a decision support checklist to be asked of any person offering alternative investment advice:

1. Is the plan under consideration a fixed income plan (as opposed to a variable, market-based plan, with no provision for incremental income)?

2. What is the rate of return represented in the plan?

3. Is this a ***guaranteed rate*** of return for the entire period of the plan or merely an estimate (a structured settlement is fully guaranteed to the recipient for the term of the structure)?

4. Is the income represented in the plan ***tax free*** (structured settlement income is absolutely tax free)?

5. Does the plan provide ***guaranteed indexation*** to offset inflation (a structured settlement plan can be formulated to include this)?

6. Does the plan provide an additional ***guarantee to a designated secondary payee/beneficiary*** (a structured settlement plan can be formulated to include this)?

7. Does the plan provide ***protection against the payment of taxes and/or capital gains*** upon the death (a structured settlement plan can be formulated to include this)?

8. Is the plan ***judgment proof*** (a structured settlement, effectively, is)?

9. Are there any additional management fees with the plan (with structured settlements, there are ***no management fees***)?