Structured settlements: are they on the way?

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Have you heard of structured settlements? Do you know what they are and how they work? If the answer is no, don't worry, you are not alone. Most Australian lawyers are unfamiliar with structured settlements. To date this has not been a problem. Lump sum common law compensation is, after all, the norm.

But times are changing. Structured settlements are increasingly used overseas in the United Kingdom, Canada and the United States. They are likely to be used here from as early as next year.

This article is a practical guide to what you need to know about structured settlements and how they will affect your practice.

What are they?

Structured settlements are a method of paying personal injury compensation. They are an alternative to a conventional single lump sum damages payment. Structured settlements usually combine an up-front lump sum with ongoing periodic payments.

Where do they come from?

Structured settlements were first used in the United Sates and Canada in the late 1970's, when the Tax Offices in both countries confirmed their tax free status. They became increasingly popular during the 1980's and this growth had continued to date.

Structured settlements were introduced in the United Kingdom in the late 1980's, when the Inland Revenue confirmed their tax free status. Legislative amendments to the *Income and Corporation Taxes Act* 1988 (UK) in 1995 and 1996 encouraged their broader use. The number of personal injury cases being settled using structured settlements is steadily growing.

How do they work?

When a structured settlement is agreed to between the parties to a personal injury case, the claim is paid as follows. The defendant, or its insurer, pays a portion of the settlement sum to the claimant as an up-front lump sum and uses the remaining portion to purchase an annuity for the claimant.

The defendant general insurer purchases the annuity from a an annuity provider, which is usually a life insurance company. The general insurer is then released from liability and closes its file. The life insurer makes the ongoing periodic payments to and has the ongoing relationship with the claimant.

When do you use them?

Structured settlements are most appropriate for settling large cases involving claimants who have been seriously injured and who have long term medical care requirements.

For these claimants it is particularly important that their compensation provides them with a lifelong flow of funds to meet their ongoing needs.

What's wrong with lump sums?

The main problem with lump sums is that they tend to run out. Studies undertaken in Australia and overseas in relation to the adequacy of lump sums have shown that they often fail to meet long term needs.

At the time of settlement a large lump sum compensation payment can seem like an enormous amount of money. It can give claimants a false sense of financial security. They often spend the money unwisely, dissipating the funds too quickly. Claimants are often young, with little concept of how long they might live. They are often subject to pressure in the form of requests for financial assistance from friends and family members.

It usually takes time for claimants to realise that all the money is in fact needed to meet their ongoing needs. Often that realisation dawns too late.

It takes skill and expertise to know how to invest a lump sum so as to generate an income stream for life. Making the right investment decision is difficult at the best of times, let alone after the trauma of a serious injury and legal battle.

Sometimes lump sums don't last even if prudently invested; sometimes the original amount awarded or paid is insufficient. This may be because of reductions for contributory negligence, or because the discount rate used in calculating the lump sum is too high.

Another problem with lump sums relates to life expectancy. If the parties or the court underestimated the claimant's life expectancy when calculating damages, then the damages will be inadequate.

Why use structured settlements?

Structured settlements offer claimants lifelong financial security and peace of mind. They take away the worry associated with having to invest and manage a large lump sum. Structured settlements shift the risk and responsibility of money management from the claimant or his/her family to the annuity provider, usually a large life insurer.

The life insurer takes on the investment risk and the mortality risk associated with the claimant's life expectancy. The parties need only agree upon annual care costs. The annuity can provide that the periodic payments are simply payable "for life". This gives claimants peace of mind. Annuity providers are better placed than individual claimants to bear the risks associated with life expectancy.

Structured settlements offer flexible payment options. Within the context of the available settlement funds, claimants can "structure" the payments to suit their individual needs and preferences. At the time of settlement, claimants can specify features such as the amount of the up-front lump sum, the amount and frequency of the periodic payments (eg paid weekly, monthly, quarterly, annually), the amount and frequency of any periodic lump sums, and the inclusion of guarantee periods.

Structured settlements make sense from a government perspective. They will in fact save the government money, by reducing pressure on the welfare system. At present, when lump sum compensation runs out, claimants fall back on the government for support. This includes income support as well as community health services.

Identifying appropriate cases

The introduction of structured settlements will mean that as a plaintiff lawyer involved in personal injury cases you will need to ask yourself, in relation to your existing cases and any new cases, *"Would a structured settlement be appropriate in this case?"*.

In order to identify appropriate cases, ask yourself the following questions:

1. Does the case involve serious injuries that will require lifelong medical treatment and care? Brain damage, quadriphegia, and paraplegia are obvious examples.
2. Does the case involve a high level of damages?
3. Does the case involve a minor?
4. Is your client's life expectancy reduced or uncertain?
5. Does your client have limited financial management skills or does he/she wish to avoid the stress and responsibility involved in the investment of a large lump sum?
5. Is there a danger that your client's damages award will be prematurely dissipated, before it has served the function of compensating for future needs? Does your client have spendthrift tendencies, or is he/she addicted to drugs, alcohol or gambling? Might your client be subject to pressure from relatives, "friends" or charities, and would he/she be in a better position to resist their financial requests if a lump sum has not been received?

Raising the issue

If the answer to one or more of the above questions is yes, then structured settlements ought to be considered and raised as a possibility with your client. You need only explain to your client in basic terms what a structured settlement is and what it has to offer as opposed to a conventional lump sum.

If your client is interested in exploring the possibility of using a structured settlement then you should raise the issue with the lawyer for the defendant or its insurer. Ascertain whether they are open to the idea of using a structured settlement. You may need to explain in basic terms what a structured settlement involves, if they are unfamiliar with the concept.

Structured settlement intermediaries

Once it has been established that both parties are open to the possibility of using a structured settlement, you will need to contact a structured settlement intermediary. These intermediaries are effectively insurance brokers who specialise in structured settlements. They carry out the work involved in obtaining annuity quotes.

You will need to provide the intermediary with information about your client's present and future financial needs and the (expected) settlement sum available. They will discuss structured settlement design options with you and search the annuity market to obtain quotes on annuities which best meet with client's needs.

This work should ideally take place as early in the settlement process as possible, so as to give you and your client a good feel for the type of structured settlement that would be a good settlement outcome.

Settlement negotiations

Settlement negotiations involving structured settlements are not very different to ordinary sum lump sum negotiations. As legal counsel for a claimant, your objective is to secure the best possible settlement outcome for your client. You will aim to maximise the total settlement sum, whether this sum is paid in the form of a lump sum or a structured settlement.

As with lump sum negotiations, the primary focus will remain on the total settlement sum. The details of the structured settlement will flow from this sum; namely the amount to be paid as an up-front lump sum, the amount to be used to purchase the annuity and the type of annuity purchased.

A structured settlement intermediary can usually attend a settlement conference with you in person and provide annuity quotes on the spot (using a computer). Alternatively he/she can be available on telephone call to provide quotes upon request.

Structured settlement intermediaries can work quickly and obtain new and updated quotes at short notice. This may be necessary as settlement negotiations between the parties proceed and intensify.

The settlement agreement

In the end, your client will need to decide whether to accept a lump sum or a structured settlement. It will come down to a decision as to which settlement option best suits the claimant's needs. Your advice to your client will depend upon the particular circumstances of each case.

Final comments

Structured settlements are not a cure-all. They will not be appropriate in all cases, nor will they suit all claimants. They will not convert an inadequate settlement sum into adequate ongoing funds.

But they are a settlement option that should be available to claimants in Australia. They are a practical and financially responsible compensation method.

So keep an eye on legislative reform developments. The introduction of structured settlements will be good news not only for your clients, but for all Australians generally. ■

Jane Ferguson is the Manager of the NSW Motor Accidents Authority Structured Settlement Project. The project will culminate early next year with a submission to the Commonwealth Government for specific amendments to the Tax Act that will encourage the use of structured settlements in Australia. Jane is currently based in Sydney. She may be contacted on **phone** 02 9334 8876 or **email** janeferguson@compuserve.com

Editors Note: Members with views or experience in structured settlements are invited to respond to this article. Your letters or comments will be published in future editions of *Plaintiff*.