Structured Settlements

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For personal injury and workers' compensation clients considering whether to structure their settlement, today's volatile economic environment raises questions. Should they place their funds in a structured annuity? Or should they take the money in a lump sum and hope to do better in the investment markets?

Comparing Returns

Life insurance companies that offer structured settlement annuities use a number of underlying investment vehicles to determine the quoted annuity yield. A typical annuity portfolio is made up of investment-grade corporate bonds and government bonds. Under five percent is invested in the stock market. The result is a blended rate that is significantly higher than say long-term Treasury yields.

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Because life insurance carriers are not tied to any one interest rate when establishing the yield for a structured settlement annuity, rate flexibility over the long term means higher yields. The returns become even more attractive because they are state and federally tax-free.

Factoring in the tax-free feature, the real rate of return on a structured settlement annuity is often greater than a similar quality taxable investment. This is particularly true in California where state income taxes are high.

In one recent automobile accident

case, a 45-year-old-female was injured when her car was rear-ended by a drunk driver. Her attorney suggested she place $240,000 of her settlement in a lifetime annuity.

After talking with the injured party about her current and future financial needs, a payment plan was created that enabled the client to receive $1,000 per month for life, guaranteed over 20 years. When factoring in her life expectancy, the actual benefit is expected to reach $482,000. The "life contingent" aspect to structured settlements means injured parties cannot outlive their settlement income. The taxable equivalent yield in this case is 2.76 percent based on California's marginal tax rate of 28 percent.

The client could have decided to collect all of her settlement in a lump-sum and then placed it in a money-market account (with rates hovering near zero) or a 30-year Treasury bond (currently yielding are around 1.3 percent). Any generated income would be taxable in the year it is received. By placing the settlement funds in a structured annuity, the money compounds tax-free and is considered tax-free income when withdrawn for her and her heirs.

In another case, a 30-year-old male was injured on a construction job. His lawyer suggested a lifetime annuity in a structured settlement that included a 3 percent a year inflation factor. The injured party receives $1,000 per month during the first year of the structure, but the amount increases 3 percent annually, so that the value of the monthly payments keeps up with the cost of living. The amount of monthly payments will continue to increase at the 3 percent rate for as long as he lives. The taxable equivalent yield is 2.9 percent based on a 28 percent marginal tax rate.

A Regulated Industry

Life insurance carriers offering structured settlement annuities in California include Prudential, Pacific life, MetLife, New York Life, USAA and Berkshire Hathaway. All are rated A+ or higher by A.M. Best.

State insurance regulators place tight restrictions on the type of investments life insurance companies can place into an annuity. No start-up stocks or junk corporate bonds. On top of that, insurers are subject to mandatory annual audits and must follow state regulations that require insurance companies to abide by strict solvency standards to protect customer assets.

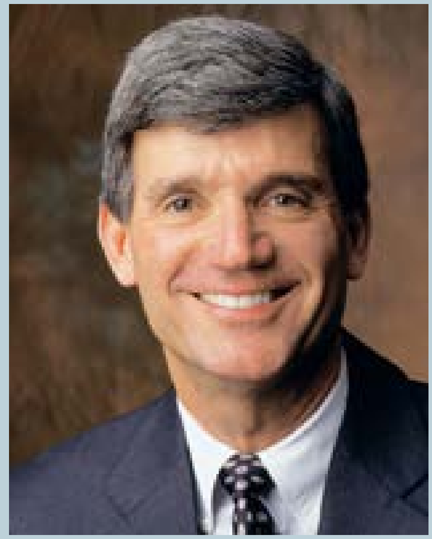
Reasons to Structure A Settlement

Clients who are considering a structured settlement are primarily interested in a steady stream of guaranteed, tax-free income for a number of years or the rest of their lives. This is particularly important now. The COVID-19 pandemic is a good reminder that the markets and the economy can become volatile without warning leaving investment plans in ruins.

For clients who are not investment savvy (and even those who are), attempting to invest in erratic markets after receiving a large amount of cash can be daunting. Mistakes are often made that can quickly reduce the settlement proceeds.

Cost should also be considered. Most non-structured investments charge annual management and administrative fees that can cut into returns. Structured annuities charge a one-time upfront fee.

Experiencing an injury can be life changing for many clients and their families. Financial decisions add another layer of stress. A structured settlement's guaranteed income regardless of the economy or market conditions can be an attractive option.



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