TAX TREATMENT OF STRUCTURED SETTLEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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TAX TREATMENT OF STRUCTURED SETTLEMENTS

THURSDAY, MARCH 18, 1999

House of Representatives,
Subcommittee on Oversight,
Committee on Ways and Means,
Washington, DC.

The Subcommittee met, pursuant to call, at 1 p.m., in room B–318, Rayburn House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 11, 1999
No. OV–3

CONTACT: (202) 225–7601

Houghton Announces Hearing on Tax Treatment of Structured Settlements

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the tax treatment of structured settlements. The hearing will take place on Thursday, March 18, 1999, in room B–318 Rayburn House Office Building, beginning at 1:00 p.m.

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include an official from the U.S. Department of the Treasury and representatives from the National Structured Settlements Trade Association and the National Association of Settlement Purchasers. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Present law provides tax-favored treatment both to the payor and recipient of "structured settlements" for damages paid as a result of personal injury. A structured settlement consists of a series of set payments made over a determinable period of time for damages paid as a result of personal injury.

Generally, section 130 of the Internal Revenue Code grants tax-favored treatment to structured settlements payments. If the payments qualify, the payor can deduct the amount of payments made to the recipient, and the recipient can exclude the same amount from income. To qualify for tax-favored treatment under section 130: (1) the payments must be fixed as to amount and time, (2) the payments cannot be accelerated, deferred, increased, or decreased by the recipient, (3) the payor's obligation is no greater than the liable person's obligation, and (4) the payments are excludable by the recipient as those under section 104(a)(2) of the code.

In recent years, firms called "factoring companies" have purchased from recipients the right to receive their periodic payments. Generally, the recipient receives a lump-sum amount at a discount from the present value of the payment stream. There is some question whether these transactions violate section 130 by "accelerating" the payments, calling into question the exclusion for the payor and whether a portion of the payment may be includable as income to the recipient. Critics of these transactions have also argued that factoring companies take advantage of the recipients who may depend on the flow of income. Those who favor such transactions contend that they do not violate section 130 and that some recipients are well-served by the opportunity to receive lump-sum payments.

The President, in his fiscal year 2000 budget, proposed an excise tax of 40 percent on the difference between the amount paid by the factoring company and the value of the acquired income stream. The proposal included an exception for purchases entered into under court order finding of hardship.

Representatives E. Clay Shaw, Jr., (R–FL) and Fortney "Pete" Stark, (D–CA) introduced H.R. 263, a bill which provides for a 50 percent excise tax on the discount with an exception for court-approved hardship to the recipient.

In announcing the hearing, Chairman Houghton stated: "When Congress last addressed the tax treatment of structured settlements, it could not have foreseen the market that currently exists in the purchase of structured settlements. It is timely and appropriate that the Subcommittee examine the tax treatment of these transactions. I am looking forward to hearing both sides of this debate.”

FOCUS OF THE HEARING:

The hearing will focus on the tax treatment of structured settlements and legislative proposals to alter the tax treatment of the purchase of structured settlements.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the *close of business*, Thursday, April 1, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at “http://www.house.gov/ways__means/”.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman HOUGHTON. Good afternoon, ladies and gentlemen. Thank you very much for being here.

We will begin the Ways and Means Subcommittee hearing on the tax treatment of structured settlements. We are going to review a matter that may be of little importance to most taxpayers, but it is of great importance to many who have experienced personal injuries. We are here, of course, to review the tax treatment of structured settlements.

Structured settlements, in a word, are a series of set payments made over a specific period of time for damages incurred as a result of a personal injury. The Internal Revenue Code provides tax-favored treatment to structured settlements. There are some important limitations. For example, payments must be fixed in amount and duration. The payments cannot be accelerated, deferred, increased, or decreased by the recipient.

In recent years, factoring companies have been purchasing structured settlements and providing the recipients with lump-sum payments. These transactions raise two important questions. First of all, do they run afoul of the requirement that recipients cannot accelerate payments? Second, do recipients suffer by accepting a lump-sum payment at a discount, rather than a guaranteed payment stream?

Both the administration and our colleagues, Mr. Shaw and Mr. Stark, have proposed an excise tax to discourage these transactions. So, today, we will hear from the administration and from people on both sides of this debate.

But before hearing from the Treasury and my two associates, I would like to yield to our ranking Democrat, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

I just want to point out that I am a cosponsor of Mr. Stark's and Mr. Shaw's legislation. I would just like to submit my statement for the record, and yield to Mr. Stark for his statement.

Chairman HOUGHTON. Absolutely.

[The opening statement follows:]

Opening Statement of Hon. William J. Coyne, a Representative in Congress from the State of Pennsylvania

Today's hearing will focus on an issue which has generated much attention in recent months—the proper tax treatment of settlement agreements.

Current tax law provides for tax advantages to injured parties choosing to receive their damage awards in the form of structured settlements, rather than in lump sums.

The Congress decided many years ago, and correctly so, that injured individuals should be encouraged to receive their damage awards over time, as periodic payments. This insures that they have the funds needed to meet their ongoing living needs and medical costs.

More recently, questions have been raised about the practice of "factoring" settlement agreements. In other words, individuals have been selling their settlement award payments in exchange for a lump-sum amount at a significant discount.

One response to this situation has been legislation introduced by Congressmen Shaw and Stark—H.R. 263. I have joined in co-sponsoring this bill which would impose a 50 percent excise tax on factoring transactions. A similar proposal has been offered by the Administration which we will discuss further today.

The discussion this afternoon should be insightful. I welcome our review of the tax policy concerns underlying current law, and the business dynamics of the settlement industry and factoring transactions.

As we proceed, I hope that we keep in the mind those for whom this controversy really matters—those thousands of injured individuals and their families.

Mr. STARK. Thank you. I hadn't meant to preempt Mr. Shaw. Mr. Chairman, thank you.

I am here with my colleague, Mr. Shaw, because we are concerned about an arrangement that has worked pretty well for two decades.

I chaired the Select Revenue Measures Subcommitee when we enacted this bill in 1982. I was skeptical then that the finance sharks were out there just finding a way to reduce what the courts might offer in a way of tort settlements.

But as we saw this unfold, it became apparent that there was some great social value in a structured settlement in protecting, particularly in protecting people who first of all might not have had any acquaintance with handling large sums of money or investing it, or indeed, budgeting it.

The stories of people who received large lump-sum settlements and squandered them were equally heart rending, some ended up back on welfare if they were in fact disabled. It made great good sense then, and I think it makes great good sense now.

The problem is that over the course of some years, people with a great deal more understanding of the cost of things and the value of things have found a way to arbitrage or buy these payments at a discount. You are going to hear later, I'm sure, in testimony, many tales of people whose lives have been disrupted, if not destroyed by the fact that they in a very unsophisticated way, squandered their benefits.

We are therefore, suggesting that what was originally a social issue, a consumer protection issue, needs some fine-tuning.

You may hear some testimony today that will indicate that this ought not to be a tax issue. This is a consumer protection issue. I would just like to suggest that it was no less a consumer advocate than Russell Long, who I don't think ever saw an issue of Consumer Reports in his life, but he used to say that it ain't an issue of fairness.

We decided the winners and losers in this business. I guess that is what we are here to do, to see whether we can even out the score between the winners and losers. Russell Long also said in regard to using the Tax Code to solve a problem, that he could take the Tax Code and make water run uphill. I suspect that he was correct.

I hope today that this Subcommittee will hear testimony that will encourage all of you to support the legislation that will reasonably protect these disadvantaged, and indeed, often disabled individuals, that we have been trying to protect. I know it's not often a tenet of my more conservative colleagues to say that government has a duty to protect people from themselves, but I think you are going to hear an awful lot of evidence today to suggest that in these cases, we have been doing the right thing.

I am pleased to be here with the author of this legislation, Mr. Shaw. And thank you, Mr. Chairman, for having this hearing.

Chairman HOUGHTON. Before I turn to Mr. Shaw, do you have any other testimony you would like to admit for the record?

Mr. STARK. Mr. Chairman, no.

Chairman HOUGHTON. Just your statement?

Mr. STARK. Not at this point. Thank you.
Chairman HOUGHTON. Fine.
[The opening statement follows:]

Opening Statement of Hon. Fortney Pete Stark, a Representative in Congress from the State of California

Mr. Chairman, thank you for holding this hearing today.

I am here today with my colleague, Rep. Shaw, because we are concerned that an arrangement that has worked very well for almost two decades to compensate victims of serious, often disabling, physical injuries is now being unwound. And it's being unwound by companies out to make a fast buck at the expense of injured victims. I was the chairman of the Ways and Means subcommittee that considered the original bipartisan legislation in 1982 to enact the structured settlement tax rules. The Committee adopted a bipartisan proposal to provide long-term financial protection to seriously injured victims and their families, so that they would not have to turn to taxpayer-financed assistance programs to meet their needs.

Today there is a troubling spread of structured settlement factoring transactions which threaten that policy. Factoring companies are enticing injured victims to sell off their guaranteed stream of payments for quick—but sharply discounted—cash. The long-term financial protection for the victim and their family disappears.

The factoring companies assert that they are just providing a financial service to people who need money. The public record shows otherwise. Court records show that across the country the factoring companies are buying up the financial futures of paraplegics, quadriplegics, people with traumatic brain injuries, permanently-disabled children who've just barely reached the age of majority.

This completely frustrates what our Committee intended when it adopted the original legislation to encourage structured settlements. Chairman Archer has talked about rooting out abuses and closing them down. This one we don't even have to ferret out. It is right there in front of us, and it is time we did something about it.

Rep. Shaw and I have introduced H.R. 263 as a solution to the abuses at hand. Seventeen Ways and Means Members have cosponsored this bill. Treasury supports it. The National Spinal Cord Injury Association and the National Organization on Disability have endorsed it.

I am hopeful that this hearing will prompt the favorable consideration of HR 263 by the full committee of Ways and Means. I thank my colleague, Rep. Shaw for his efforts to get this bill enacted.

Chairman HOUGHTON. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I thank you very much for having this hearing and allowing me and Mr. Stark to participate in support of H.R. 263, the Structured Settlement Protection Act.

Mr. Stark and I, along with a broad bipartisan group of colleagues, introduced this bill to address serious public policy concerns that are raised by transactions in which so-called factoring companies purchase recoveries under structured settlements from injured victims.

Congress enacted structured settlement tax rules as an incentive for injured victims to receive periodic payments as settlements of personal injury claims. I was an original cosponsor of that legislation, along with Mr. Stark. Congress was concerned that injured victims would prematurely spend a lump-sum recovery and eventually resort to the social safety net. The integrity of the entire system is being undone by factoring transactions. Injured victims are selling their settlements to factoring companies, and I might say, at very sharp discounts, for quick cash, spending it, and eventually winding up on public assistance, leaving them in the very predicament that structured settlements were set up to avoid.

These sales also create the risk that the special tax treatment, accorded to the original structured settlement, no longer applies after a sale. Thus, the uncertainty caused by factoring transactions may hinder the use of structured settlements themselves.

H.R. 263 addresses these concerns in the following manner. To discourage factoring transactions, the bill imposes an excise tax on the factoring company. Essentially, 50 percent of the amount of the discount is being taxed. Because of the sharp discounts at which many of these purchases are made, an excise tax of 50 percent is necessary to act as a real deterrent to factoring transactions.

The excise tax on a factoring company will not apply to a sale of a structured settlement in a court-approved hardship. The reason for this exclusion is simple. It is to provide for flexibility for those injured victims that need it, and have a genuine reason to sell their settlements.

Finally, the bill clarifies that a subsequent transfer of structured settlement payments will not jeopardize the original tax treatment of the other parties to the settlement; namely, the settling defendant and the financial institution assuming the liability to make periodic payments.

If the parties originally complied with the structured settlement tax rules when entering into the structured settlement, then their tax situation should not be changed on a subsequent sale of the settlement and over which they have no control.

The way to deal with the abuses involved in factoring transactions, the aggressive sales practices, and the sharp discounts is not through State consumer protection laws or through lawsuits. Because the purchase of structured settlement payments by factoring companies so directly thwarts the congressional policy underlying the structured settlement tax rules, and raises such serious concerns for structured settlements and injured victims, it is appropriate to deal with these concerns in the tax content.

I want to thank Representative Stark for his support and assistance working together with him in enacting this bill. I urge my colleagues to do the same. Again, Mr. Chairman, I want to thank you for holding, I think what is a most important hearing on this most important matter.

Thank you.

Chairman HOUGHTON. Thank you very much, Mr. Shaw. I appreciate it.

Mr. Collins, do you have anything? Would you like to——

Mr. COLLINS. Mr. Chairman, I just appreciate the fact you have let me sit in on your hearing this afternoon. We do have a constituent from Georgia that is here. I appreciate the opportunity. But no statement at this point.

Chairman HOUGHTON. Thank you very much.

Mr. Watkins, would you like to make a statement?

Mr. WATKINS. I don't have one——

Chairman HOUGHTON. No, wait 1 minute. We are not going to do that here. We have heard too much about the oil patch from you. [Laughter.]

Well anyway, to continue, I would like to introduce Mr. Mikrut. I don't know you, Joe, but you used to be with the Joint Tax Committee 6 months ago. I think this is the first time you have testified in front of the Ways and Means Committee.

So, we are delighted to have you here—if you would like to give your testimony and would like to proceed.

STATEMENT OF JOSEPH M. MIKRUT, TAX LEGISLATIVE COUNSEL, U.S. DEPARTMENT OF THE TREASURY

Mr. MIKRUT. Thank you, Mr. Chairman. It is a pleasure to be here.

Mr. Chairman, Mr. Coyne, Members of the Subcommittee, and Members of the Full Committee, it is a pleasure to speak with you today about the tax treatment of structured settlement arrangements.

As you know, the administration has proposed in its fiscal year 2000 budget to impose an excise tax on structured settlement factoring transactions. The administration believes that the proposed tax, which is intended to act as a deterrent to factoring transactions, is necessary to preserve the integrity of the structured settlement tax regime and the underlying policy objective of protecting and providing for the long-term financial needs of injured persons.

Our budget proposal is very similar to H.R. 263, the Structured Settlement Protection Act of 1999, as introduced by Messrs. Shaw and Stark, and cosponsored by other Members of the Subcommittee and the Full Committee.

In my brief remarks, I would like to touch upon the following act matters: One, a description of the typical structured settlement arrangement; the favorable tax rules applicable to such arrangement; the tax and nontax policy concerns underlying such rules; a description of the factoring transaction; and finally, an explanation of how the proposed excise tax would operate in support of the legislative proposals underlying the current law. My written statement describes these matters in greater detail. I request that it be submitted for the record.

Mr. Chairman, an injured party that receives an award or a settlement for his or her injury generally has two options. One, to receive a lump sum, up front payment. Or alternatively, to receive a stream of deferred payments. If the person chooses the lump-sum payment, the transaction is over, but as described below, there may be some negative tax consequences to such a choice.

However, if the person chooses to receive deferred payments, he or she can enter into a qualified structured settlement arrangement and the inside buildup on whatever investment is within the arrangement is never subject to tax.

Qualified structured settlements typically have the following characteristics: The defendant, who is required either by a suit or by an agreement to pay damages to a physically injured or ill person, enters into a structured settlement agreement with the injured person and a structured settlement company, under which terms, the structured settlement company is required to pay the injured person specified amounts over a period of time. Pursuant to this agreement, the defendant pays a lump sum to the structured settlement company, which assumes the defendant's liability to the injured person. The structured settlement company then purchases an annuity contract, or some other qualified asset, to fund the liability and uses the payments received under that contract to pay the amounts due to the injured person.

Pursuant to legislation enacted in 1982, the tax results of the structured settlement arrangement are as follows: The defendant gets an up front deduction for his payment to the structured settlement company. The structured settlement company does not recognize income on receipt of that payment to the extent it requires an annuity or other qualified investment.

The payments to the structured settlement company are not subject to tax to the extent they are netted out as payment to the injured person. The injured person is not subject to tax on any amounts received. Taken together, these rules effectively provide that the earnings on funds set aside for the injured person are never subject to tax, in essence, giving tax-free buildup.

Conversely, if the injured party had received an up front lump-sum payment outside a structured settlement, such receipt is not subject to tax, but if the person were to invest that lump sum, any earnings thereupon would be subject to tax. Thus, structured settlement arrangements are tax-preferred investments relative to lump-sum payments.

As I said before, the rules that allow a tax-free buildup of structured settlements were first enacted in 1982. Legislative history indicates that the legislation was intended for two purposes. One, to clarify that the tax-free treatment of deferred payments to injured parties was subject to section 104.

Prior to 1983, the Treasury Department and the Internal Revenue Service had taken an administrative position similarly exempting the injured person from any tax on the earnings on certain funds set aside. Congress decided that it was much more preferable to have such law enacted statutorily.

Second, legislative history provides similar tax benefits to the structured settlement companies. This benefit, which allows no tax upon receipt of the amount from the defendant, is necessary to effectively allow the tax-free buildup on structured settlement amounts. Congress conditioned these favorable rules on a requirement that the periodic payments could not be accelerated, deferred, increased or decreased by the injured person.

It appears that certain nontax policy considerations underlie these favorable rules for structured settlements. There was a recognition that recipients of structured settlements are much less likely than recipients of lump-sum awards to consume their awards too quickly and then thereby require public assistance. It appears that Congress' tax and nontax concerns underlying structured settlements may be frustrated by factoring transactions.

In a factoring transaction, an injured party accepts a discounted lump-sum payment from a factoring company in exchange for their future payment streams under the structured settlement. These discounts may be large, and factoring transactions appear to have become prevalent.

Factoring transactions effectively contravene the statutory requirement conditioning favorable tax treatment on the injured person's inability to accelerate such payments and undermine the policy objectives for these favorable rules, that of protecting the long-term financial needs of injured persons.

By replacing structured settlement payments with a lump sum in the hands of the injured person, the factoring transaction facilitates the potential dissipation of these amounts by the injured person. Thus, the current state of affairs affords favorable tax treatment without ensuring that the legislatively intended conditions for such treatment are satisfied, thereby potentially costing Federal revenues without ensuring that the goal of long-term income protection for injured parties is achieved.

Both the President in his fiscal year 2000 budget and Representative Shaw and Stark in H.R. 263, have proposed the imposition of a substantial excise tax on discounts relative to factoring of structured settlement payments. The excise tax would not be imposed when the purchase is pursuant to a court or administrative order finding that certain extraordinary and unanticipated needs of the original intended recipient render such a transaction desirable.

The imposition of a substantial excise tax should make it far less likely that factoring transactions will occur, because the transactions would become less profitable. To the extent that the market for such purchases is reduced or eliminated, far fewer injured persons would be approached or convinced to assign their future income rights, and the integrity of the structured settlement tax regime of present law would be preserved. This will help ensure that the tax benefits conferred by present law accomplish their legislative purpose.

In conclusion, Mr. Chairman, Mr. Coyne, and Members of the Subcommittee, the administration looks forward to working with you and other Members of Congress in addressing this problem. We thank you for your interest in this issue, and for an invitation to participate in today's hearing. I am happy to answer any questions you may have.

[The prepared statement follows:]

Statement of Joseph M. Mikrut, Tax Legislative Counsel, U.S. Department of the Treasury

Mr. Chairman, Mr. Coyne, and Members of this Subcommittee, it is a pleasure to speak with you today about the current-law tax treatment of structured settlement arrangements and legislative proposals to impose an excise tax on the purchase of structured settlement payment streams.

As you know, the Administration has proposed in its fiscal year 2000 budget to impose an excise tax on structured settlement factoring transactions. The Administration believes that the proposed tax, which is intended to act as a deterrent to factoring transactions, is necessary to preserve the integrity of the structured settlement tax regime and the underlying policy objective of protecting and providing for the long-term financial needs of injured persons. Our budget proposal is very similar to H.R. 263, the "Structured Settlement Protection Act of 1999," as introduced by Messrs. Shaw and Stark and other Members of the Subcommittee and full Committee.

Following is an overview of the tax treatment of structured settlements under current law, a discussion of the rationale for these favorable rules, an analysis of the potential impact of a factoring transaction, and an explanation of how the proposed excise tax would operate in support of the legislative purpose underlying current law.

TAX TREATMENT OF STRUCTURED SETTLEMENTS

Since 1983, section 130 and other provisions of the Internal Revenue Code have contained a series of special tax rules intended to facilitate the use of structured settlements to resolve physical injury damage claims.

Structured settlements that qualify for this favorable tax treatment typically have the following characteristics: A tortfeasor who is required (whether by suit or agreement) to pay damages to a physically injured person enters into a structured settlement agreement with the injured person and a structured settlement company ("SSC"), under which terms the SSC is to pay the injured person specified amounts for a number of years or for the life of the injured person. Pursuant to the agreement, the tortfeasor pays a lump sum to a structured settlement company ("SSC"), which assumes the tortfeasor's liability to the injured person. The SSC purchases an annuity contract to fund the liability, and uses the annuity payments received under the annuity contract to pay the amounts due to the injured person.

The tax results of the structured settlement arrangement are as follows: The tortfeasor is permitted immediately to deduct the lump sum paid to the SSC, but the SSC does not include in income the amount received from the tortfeasor to the extent that such funds are used to purchase the annuity contract. The earnings on the annuity contract are taxed to the SSC according to the favorable rules generally applicable only to individual annuity holders. These rules generally defer taxation of income under the annuity contract until such time that the SSC actually receives annuity payments, at which time the SSC is eligible for a corresponding offsetting deduction for the amounts paid to the injured person. Furthermore, the injured person is not taxed on any amounts received from the SSC, even though significant portions of such payments are funded through the SSC's investment earnings. Taken together, these rules effectively provide that the earnings on funds set aside for the injured person are never subject to tax.

Prior to 1983, the Treasury Department and Internal Revenue Service had taken an administrative position similarly exempting the injured person from tax on the earnings on certain funds set aside on his or her behalf. *See*, *e.g.*, Rev. Rul. 79–313, 1979–2 C.B. 75. The legislative history to the rules enacted in 1983 explains that the statutory changes were intended, at least in part, to provide statutory certainty that the injured person was not subject to tax on the earnings from qualified structured settlements. In addition, the legislation removed potential tax impediments with respect to SSCs. *See* H. Rpt. No. 97–832, 97th Cong., 2d Sess. 4 (1982); S. Rpt. No. 97–646, 97th Cong., 2d Sess. 4 (1982). Congress conditioned the favorable rules on a requirement that the periodic payments cannot be accelerated, deferred, increased or decreased by the injured person. Both the House Ways and Means and Senate Finance Committee Reports stated that "the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments."

Although the non-tax policy considerations underlying the favorable statutory clarifications are not discussed in these reports, Senator Max Baucus (D–Mont.) described these considerations in introducing the legislation that led to the favorable tax rules. Senator Baucus explained that the recipients of structured settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance:

> In the past these awards have typically been paid by defendants to successful plaintiffs in the form of a single payment settlement. This approach has proven unsatisfactory, however, in many cases because it assumes that injured parties will wisely manage large sums of money so as to provide for their lifetime needs. In fact, many of these successful litigants, particularly minors, have dissipated their awards in a few years and are then without means of support.
>
> Periodic payments settlements, on the other hand, provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards....

[*Congressional Record* (daily ed.) 12/10/81, at S15005.]

Since 1983, Congress has further expressed its support of structured settlement arrangements. In the Taxpayer Relief Act of 1997, Congress extended the section 130 exclusion to cover qualified assignments of liabilities arising under workmen's compensation acts. In deciding to extend such favorable tax treatment, "the Committee was persuaded that additional economic security would be provided to workmen's compensation claimants who receive periodic payments if the payments are made through a structured settlement arrangement, where the payor generally is subject to State insurance company regulation that is aimed at maintaining solvency of the company, in lieu of being made directly by self-insuring employers that may not be subject to comparable solvency-related regulation." *See* H. Rpt. No. 105–148, 105th Cong.,1st Sess. 410–11 (1997).

THE FACTORING ISSUE

Many injured persons are willing to accept heavily discounted lump sum payments from certain "factoring companies" in exchange for their future payment streams from structured settlements. These factoring transactions directly undermine the policy objective underlying the structured settlement tax regime, that of protecting the long-term financial needs of injured persons. The factoring transactions also effectively contravene the statutory requirement conditioning favorable tax treatment to the various parties to the arrangement on the injured person's *inability* to accelerate such payments.

The same policy considerations expressed in introducing the structured settlement tax legislation in 1981 remain relevant today. Dissipation of an award by an injured person who is unable to earn money because of his or her injury or illness may result in the need for welfare payments or other public assistance. By replacing structured settlements with a lump sum in the hands of the injured person, the factoring transaction facilitates potential dissipation.

Factoring transactions are prevalent today. According to recent press reports, one large factoring company has completed more than 15,000 structured settlement transactions with an approximate total value of $370 million. The company broadcast more than 90,000 television commercials in a period of less than two years. *See* Margaret Mannix, "Settling for Less," *US News & World Report*, p. 63 (January 25, 1999); Vanessa O'Connell, "Thriving Industry Buys Insurance Settlements from Injured Plaintiffs," *The Wall Street Journal*, p. A8 (February 25, 1998).

We understand that almost all structured settlement arrangements contain anti-assignment clauses that are intended to satisfy the section 130 statutory requirements. The fact that only companies able and willing to contravene these anti-assignment clauses can engage in factoring transactions allows such companies to pay heavily discounted amounts for payment rights. While one large factoring company reports an average discount rate of 16%, there have been reports of rates that in some cases have exceeded 75%. *See US News & World Report*, *id*. at 66; *see also* Gail Diane Cox, "Selling Out Structured Settlements: Abuses in Secondary Market Leads to Reform Legislation," *The National Law Journal*, p. B1 (August 18, 1997).

In sum, the Administration believes that the factoring transaction undermines the purpose of the special favorable tax rules applicable to structured settlements. In fact, the combination of the existing statutory requirements and the willingness of certain companies to ignore those requirements (but to exact heavy discounts in so doing) leaves injured persons potentially more vulnerable than before the enactment of the 1983 changes. The current state of affairs affords favorable tax treatment without ensuring that the legislatively-intended conditions for such treatment are satisfied—thereby costing federal revenues without ensuring that the goal of long-term income protection for injured persons is achieved.

THE PROPOSED FACTORING TRANSACTION EXCISE TAX

Both the President, in his fiscal year 2000 budget, and Representatives Shaw and Stark, in H.R. 263, have proposed the imposition of a substantial excise tax on the difference between the amount paid by the factoring company and the undiscounted value of the acquired payment stream. The excise tax would not be imposed where the purchase is pursuant to a court (or administrative) order finding that certain extraordinary and unanticipated needs of the original intended recipient render such a transaction desirable. H.R. 263 also would provide that factoring transactions would not retroactively affect the tax treatment of the original parties to the structured settlement transaction.

The imposition of a substantial excise tax should make it far less likely that factoring transactions will occur, because the transactions would become less profitable. To the extent that the market for such purchases is reduced or eliminated, far fewer injured persons would be approached or convinced to assign their future income rights, and the integrity of the structured settlement tax regime would be preserved. This will help ensure that the tax benefits conferred by section 130 accomplish their legislative purpose.

The Administration recognizes that the policy concern underlying the proposed tax—the long-term financial protection of injured persons—could also be addressed outside the Internal Revenue Code. However, such policy concern already underlies the favorable tax rules applicable to structured settlements. The proposed excise tax is intended to ensure the continued effectiveness of the existing tax rules in protecting the long-term financial security of injured persons. In addition, as of the close of calendar year 1998, we are aware of only three states—Illinois, Connecticut and Kentucky—that have passed laws requiring court approval of and fuller disclosure in connection with factoring transactions, and it is unclear whether and when other states might pass similar consumer protection laws.

In conclusion, Mr. Chairman and Mr. Coyne, and Members of this Subcommittee, the Administration looks forward to working with you and other Members of Congress in addressing this problem. We thank you for your interest in this issue, and for inviting us to participate in today's hearing.

Chairman HOUGHTON. OK. Thank you very much, Mr. Mikrut. I am going to start with Mr. Coyne.

Mr. Coyne, would you like to ask any questions?

Mr. COYNE. No.

Chairman HOUGHTON. Let me see. Mr. Collins, have you got questions?

Mr. COLLINS. Not at this time.

Chairman HOUGHTON. OK.

Ms. Dunn.

Mr. Watkins.

Mr. WATKINS. I don't at this time, Mr. Chairman. Mr. Chairman, there are several questions that do come about when we start looking at taxing of settlements and different things and how they prorate them out. I may want to follow back up with some of those questions in a more serious discussion on that.

Mr. MIKRUT. I will be happy to answer any questions you have, Mr. Watkins.

Mr. WATKINS. Thank you.

Chairman HOUGHTON. I have three questions. First of all, it involves the Treasury. Has the Treasury Department taken any action with the structured settlement companies, one way or another, to explain what the tax consequences are, when a recipient has sold his or her settlement to a factoring company?

Mr. MIKRUT. No, Mr. Chairman, we have not. Under present law, it is unclear what happens to both the recipient and the settlement company when these amounts are factored. I believe some have taken the position that to the extent that the amount is assigned, that section 130 does not apply and would not apply from the inception. Therefore, the settlement company would be subject to tax, and the recipient would be subject to tax on the earnings thereon.

Others read the Code differently and would seem to indicate that section 130 still applies for several reasons. One, from the literal reading of the Code. Two, that the settlement company itself does not know, many times, whether the amount has been factored or not.

I would say at present, it is unclear what happens with respect to these sales. H.R. 263 would clarify that treatment and essentially say that so long as the original requirements of section 130 were complied with at the outset of the transaction, that that treatment would maintain throughout.

Chairman HOUGHTON. OK. Now look, just let me talk about the time. We have got a vote coming up now. I don't know how many can come back, but I will just finish with a couple of questions. Then, we will cut it and we'll go and vote. We will come back; it will only be about a 5-minute break.

Just two other questions. If Congress clarifies the tax treatment of the other parties to the original structured settlement, does that really resolve the controversy that is before us?

Mr. MIKRUT. No. I think what would resolve the controversy, Mr. Chairman, if you were to craft an excise tax which would stop the factoring transactions to the extent that the Congress deemed that appropriate. It is unclear what the appropriate rate is. The administration proposed a 40-percent rate. H.R. 263 has a higher 50-percent rate.

I think the elasticity between various injured parties and firms would depend on their own particular facts and circumstances. But I think that the important parts are that an excise tax is necessary to back up current section 130, and also the clarification how section 130 operates after a factoring transaction.

Chairman HOUGHTON. Yes. Then the last question. Really, are these transactions consistent with the tax policy that underlies most structured settlement tax rules?

Mr. MIKRUT. No. I don't believe they are, Mr. Chairman. Section 130 is premised on the fact that the recipient cannot accelerate the payments. This is generally done between the structured settlement company and the injured party through an antiassignment clause. The factoring transactions abrogate that clause and in essence, as I mentioned before, call into question the validity of section 130 treatment.

To the extent that Congress was concerned about these payments being paid over time, the factoring transaction completely undoes that.

Chairman HOUGHTON. OK. Well, those are all the questions I have. Unless anybody has a question, we are going to break here for about 5 minutes. Thanks very much.

Ms. DUNN. Mr. Chairman.

Chairman HOUGHTON. Have you got a question?

Ms. DUNN. I do. It just occurred to me. Is there anything in current legislation that provides for waiver situations, like a change of lifestyle, for example, if somebody marries and wants to convert the settlement to a lump sum to buy a home or something? Is there any waiver ability right now?

Mr. MIKRUT. Ms. Dunn, there is not under present law, but there would be under H.R. 263.

Ms. DUNN. Thanks, Mr. Chairman.

Chairman HOUGHTON. OK. Good. Well, thanks very much.

Mr. COLLINS. Mr. Chairman.

Chairman HOUGHTON. Yes. Go ahead.

Mr. COLLINS. One quick question to Mr. Mikrut. In order to clear up the tax treatment, we could do that with a provision of clarity without the excise tax, could we not?

Mr. MIKRUT. Yes, you could. You could clarify the treatment of the recipient, as well as the treatment of the structured settlement company. The excise tax, however, is intended to inhibit the factoring transactions themselves.

Mr. COLLINS. That is the truth? It is intended to stop the transaction itself?

Mr. MIKRUT. Yes. Not the setup of the original establishment of the structured settlement, but the later factoring of those amounts.

Mr. COLLINS. But it is a way that would probably eliminate the structured settlements totally?

Mr. MIKRUT. No. I believe it would backstop the structured settlements because it would allow the amounts to be paid over time as originally intended, as opposed to being accelerated.

Mr. COLLINS. That is the structured settlement. But it would penalize and probably cease the purchase of those structured settlements because of the punitive tax that would be levied against the settlement, against the purchase?

Mr. MIKRUT. No. Because, again, as long as the taxpayer and the structured settlement company stayed within the bounds of the original section 130, there would be the tax-free buildup as Congress intended. It would only be when another party came in and bought up those deferred payment rights that the excise tax would kick in.

Mr. COLLINS. That is exactly right. That excise tax would have a tendency to stop that purchase of that structured settlement. The structured settlement, the settlement company itself would not be affected because that cash flow remains the same?

Mr. MIKRUT. That's right.

Mr. COLLINS. Their cash flow remains the same to the person or the company or the entity that purchased the settlement?

Mr. MIKRUT. That's right.

Mr. COLLINS. The excise tax itself would be a punitive issue, a measure to stop the purchase of those settlements?

Mr. MIKRUT. That is correct.

Mr. COLLINS. Thank you.

Chairman HOUGHTON. OK.

[Recess.]

Chairman HOUGHTON. Again, I apologize for the interruption of the vote. We had a vote on the rule; we have a little breathing space now.

The next group of panel members starts with John Chapoton, a partner from Vinson & Elkins, on behalf of the National Association of Settlement Purchasers, along with Tim Trankina, chief executive officer of Peachtree Settlement Funding in Georgia.

We also have Thomas Little, president of Little, Meyers, Garretson & Associates in Cincinnati, and past president of the National Structured Settlements Trade Association; Donna Kucenski from Seneca, Illinois, on behalf of the National Association of Settlement Purchasers; and Thomas Countee, who is the executive director of the National Spinal Cord Injury Association in Silver Spring, Maryland.

We will start with Mr. Chapoton.

STATEMENT OF HON. JOHN E. CHAPOTON, PARTNER, VINSON & ELKINS, LLP; ON BEHALF OF NATIONAL ASSOCIATION OF SETTLEMENT PURCHASERS; ACCOMPANIED BY TIMOTHY J. TRANKINA, CHIEF EXECUTIVE OFFICER, PEACHTREE SETTLEMENT FUNDING, ATLANTA, GEORGIA

Mr. CHAPOTON. Thank you, Mr. Chairman. I appreciate the opportunity to be here today. As you mentioned, I am appearing on behalf of the National Association of Settlement Purchasers.

Accompanying me today is Tim Trankina, who is chief executive officer of Peachtree Settlement Funding, a structured settlement purchasing company in Atlanta. I am a tax lawyer. I am here to address the tax issues that are confronting this Subcommittee.

This is an industry dispute. It is not a tax issue. In my view, it is not an issue that ought to be resolved by the tax writing Committees. As you have heard, it is alleged that there are abuses in the purchases of structured settlements.

If there are abuses, they should be addressed. NASP supports any reasonable change that will give the consumer adequate information to make a correct choice, both at the time he or she enters into the structured settlement and at the time he or she is later considering a sale. If there is a problem, it is a consumer protection problem and not a tax issue.

What I would like to do today is clear up some misunderstanding concerning the meaning and history of section 130 and the amendments to section 104 that were originally adopted in 1982.

First, let me address the point that you have already heard today, that the purpose of the 1982 legislation was to provide an incentive in the tax law to encourage structured settlements. That is not entirely true. The legislation was adopted to codify IRS ruling policy that had existed in the late seventies and into the early eighties. The IRS adopted a position in both private rulings and published rulings that would not place a tax hurdle in the path of structured settlements. Congress liked it, and Congress adopted it.

At that time, Treasury expressed some concern about it because there was some tax slippage. As I believe Mr. Mikrut pointed out, any structured settlement does involve an interest element.

If a structured settlement is used, under the Code provisions adopted in 1982, that interest is converted into a tax-free award for a personal injury to the recipient, while at the same time the payor gets a full deduction for the full amount paid, including the interest payment. There is some tax slippage. Treasury expressed some concern, but Treasury did not stand in the way of the provision in 1982.

Unquestionably in 1982, everyone involved then was talking about catastrophic injuries. Everybody thought it was clearly desirable if the tax law permitted tax-free, long-term payout in such cases. Sometimes the 1982 legislation is described as protecting people who cannot protect themselves.

Congressional support in 1982 for tax rules that would permit long-term payouts in catastrophic injury cases is a far cry from the interpretation some are now putting on the 1982 congressional action.

Today we hear that Congress had adopted a rule that said if you accept this tax benefit designed for catastrophic cases, designed to keep you from being a ward of the State, you are on notice that you are forever locked in, and can never use this stream of payments as an asset for any financial purpose.

It is even more of a reach to suggest that Congress intended this to be the rule in the thousands of settlements involving lesser injuries that are also granted the option to take long-term payouts tax free under this tax benefit. In my view, that wasn't the congressional intent in 1982. I doubt it is the congressional policy today.

In brief, the congressional decision in 1982 was to grant a benefit, but not to attach a condition to that benefit and not to impose what is now being described as a lock-in, one-way swinging trap door that you cannot get out of. That is, if there is a sale to require that the structured settlement company pay a tax when the sale is made. Those conditions I submit, were not the intent.

The 1982 congressional action was simply a codification of then-existing IRS ruling practice. I discuss this in some detail in my written statement. The words of section 130 that people point to as creating this tax problem were in fact language drawn from the IRS ruling policy. That language was put in the statute. It had no other purpose than to avoid constructive receipt, and certainly not the lock-in policy that is now being attributed to it today.

More proof that this was not the policy in 1982 and should not be the policy today is found in a wide variety of fact situations in which long-term payouts are selected by claimants.

There is no one-size-fits-all. The facts vary far too much. Some involve private catastrophic permanent disability that render the claimant unemployable, where sales should not be permitted. At the other end of the spectrum, they involve the creation of a financial asset, the use of which should not be denied the owner when his or her circumstances change.

Distinguishing between these two extremes is not easy. It should certainly not be legislated by a single Federal tax rule. It is not a tax problem. It calls for careful, thoughtful, consumer protection regulation. I think the need for flexibility becomes particularly obvious when it is realized that once these benefits were firmly ensconced in the Code in 1982, the use of structured settlements has grown dramatically. Some 50,000 structured settlements are arranged each year.

There are estimates that there are $10 billion in premiums a year, from almost nothing in the late seventies. A large part of this growth has nothing to do with catastrophic injuries. I am advised that over 85 percent of structured settlement claimants are not disabled and are gainfully employed. More than 50 percent of the structured settlements involve total premiums of less than $50,000, and fewer than 13 percent of structured settlements involve settlements of greater than $250,000.

Whatever social policies are involved here, they do not justify locking every informed and properly advised claimant into a box and preventing him or her from selling a portion or all of his future payments. Circumstances change. I am told the settlement purchasers are on average first contacted by claimants some 5 to 7 years into their structured settlement. A secondary market has quite appropriately evolved to fill that need.

Thank you, Mr. Chairman. I will be happy to answer any questions.

[The prepared statements and attachments follow:]

Statement of Hon. John E. Chapoton, Partner, Vinson & Elkins, LLP; on Behalf of National Association of Settlement Purchasers

Mr. Chairman and Members of the Subcommittee:

My name is John E. Chapoton and I appear before you today on behalf of the National Association of Settlement Purchasers (NASP). I am a partner with the law firm of Vinson & Elkins here in Washington. Accompanying me today is Tim

Trankina, CEO of Peachtree Settlement Funding, a structured settlement purchasing company located in Atlanta, Georgia.

I was the Assistant Secretary of Treasury for Tax Policy from 1981 to 1984. I served in that capacity at the time the tax provisions under discussion today were enacted. I testified before the Ways and Means Subcommittee on Select Revenue Measures about these provisions, and was actively involved in the development of the legislation.

I want to discuss the tax issues presented by the 1982 legislation and by the proposal before you today. From my reading of the record from 1982, and my memory of that process, I believe there are some misconceptions concerning the original tax issues that need to be clarified. I believe they bear on the task before you.

BACKGROUND

A structured settlement is a financial arrangement that resolves a personal injury or wrongful death claim with an agreement to make payments over time instead of in one lump sum. This vehicle is often very useful in settling litigation or potential litigation. Structured settlements are used for everything from slip and fall cases to serious, lifelong injuries. They are not, and never have been, limited to catastrophic injuries, however. The perception that structured settlements typically involve lifelong disabilities is simply wrong.

Generally, under a structured settlement the beneficiary or claimant is paid over a period of years in a series of installments with inflexible payment terms. Most typically, the settlement takes the form of monthly payments, periodic lump sums, or a combination of both. It is estimated that in excess of 50,000 structured settlements are arranged each year, generating premiums to annuity companies that may be approaching $10 billion annually. These arrangements are often utilized because of the highly favorable tax treatment granted to both claimants and insurers, and because the arrangement lowers the cost to insurers of compensating personal injury victims.

According to one of the largest brokers of structured settlements, more than fifty percent (50%) of structured settlements involve premiums of less than $50,000. Fewer than thirteen percent (13%) involve settlements of greater than $250,000. Whatever the original conception of structured settlements and the purpose of the tax rules facilitating them, these figures clearly belie any assertion that they are today used principally for catastrophic injuries.

Under the terms of a structured settlement that qualifies for preferable tax treatment, the claimant is prohibited from possessing the right to accelerate, delay, increase or decrease future payments from the structured settlement company. If a claimant's life circumstances change creating a need for additional funds from the settlement, the only way the claimant may gain access to additional funds is to sell a portion, or all, of his or her settlement. This need has given rise to a secondary market where companies will purchase a portion of the individual's settlement for a lump sum payment. That lump sum reflects the discounted present value of the payments being purchased, using discount rates that presently average sixteen to eighteen percent (16%–18%). These discount rates reflect the cost of capital, the inherent risk involved, and a profit for the companies.

The National Association of Settlement Purchasers (NASP) is a non-profit trade association composed of companies that purchase structured settlement and other deferred payment obligations. Formed in July 1996, NASP and its member companies support rational regulation to protect the rights of consumers seeking to sell structured settlement payment rights. NASP has adopted a code of ethics, which includes consumer protection and suitability standards, and has created a fraud alert system. NASP is dedicated to providing claimants and their representatives with an efficient, legal and ethical means by which to obtain liquidity from inflexible structured settlement payments. NASP is actively working in a number of states to pass comprehensive legislation that protects the interests of personal injury victims both at the time of settlement, and subsequently should the individual choose to liquidate a portion of his or her structured settlement payments.

GROWTH IN THE USE OF STRUCTURED SETTLEMENTS

Historically, personal injury lawsuits were settled with an up-front, lump-sum payment to the claimant in exchange for a release of liability delivered to the defendant. The amount received by the plaintiff was exempt from taxation under Code section 104, which was originally enacted in 1919. Beginning in the 1970s IRS began issuing private rulings which permitted claimants to receive payments in settlement of personal injury claims over time on the same tax-free basis as lump sum settlements. This lead to an effort in the early 1980s to streamline and codify this

IRS ruling position. The result was enactment of the Periodic Payment Settlement Act of 1982 (the "1982 Act").

The 1982 Act did two things. First, it codified through amendments to section 104 the IRS ruling position that the full amount of settlements received over time retained their tax-free character when received by claimants. Second, and most importantly today, it enacted a new section 130 which set up favorable tax procedures that allowed defendants and their insurers to assign their liability to structured settlement companies in exchange for the purchase by the structured settlement company of an annuity to fund the liability. Technical rules specified how these assignments of liability had to take place in order to receive the favorable tax benefits.

Typical Structured Settlement Transaction

By definition, structured settlements are agreements entered into to settle actual or potential lawsuits. They may not be used after a jury has rendered a verdict. As a result, they are sometimes (approximately 25 percent of settlements) entered into without the claimant having the benefit of counsel. Often, a broker becomes involved in setting up these arrangements. Those brokers typically receive a four percent (4%) commission, which is the industry standard. A diagram illustrating the flow of funds in a structured settlement is attached.

Structured settlements are useful because they facilitate settlement of lawsuits. They allow defendants and their insurance companies to offer small settlements that look big because they are paid out over time. Most of us are familiar with the various sweepstakes awards that offer $10 million dollar prizes. It is only when you read the fine print that you discover that they are really offering $10 million over 20 years and that the real value, in present dollar terms, is far, far less. Structured settlements are often sold to claimants in the same way.

Unfortunately, many claimants who enter into structured settlement agreements do not receive this information before they settle their claim by agreeing to the long-term payout. Often the settlement is a take it or leave it offer—settle now or take your chances with litigation, which in crowded court dockets may not take place for years. Faced with this Hobson's choice, many take the settlement. As a result, claimants often discover later that (i) the settlement is really not what they expected, or (ii) after a period of time the settlement no longer fits their needs. The average length of a structured settlement is 20 years. It is impossible for an individual to predict with accuracy what his or her needs will be over the next 20 years.

Inflexibility can be the most significant flaw of structured settlements. When financial needs change, a fixed payment schedule may no longer satisfy those needs. Structured settlement purchasers have stepped in to fill that legitimate consumer need. Settlement purchase companies provide a useful and vital service for individuals to deal with unforeseeable financial situations.

Although the majority of claimants work or have other sources of support, they often need the flexibility to pledge or assign their rights to meet unanticipated needs. Many claimants use the proceeds from payment sales to pay medical and educational expenses, make bill payments or arrange debt consolidation, cope with job loss or take advantage of an unexpected opportunity such as starting or expanding a business, purchase or make improvements to a home, or start or expand a family. Occasionally, sales of a portion of structured settlements are used to pay estate taxes due on the death of the claimant.

Structured Settlement Purchases

The structured settlement purchase market has developed in response to the needs of claimants who find that a fixed schedule of payments no longer meets their needs. They make the choice of altering the arrangement to better address their present circumstances. The attached diagram shows how a typical purchase is structured.

Settlement purchasers buy the right to receive a specified amount of structured settlement payments in exchange for a lump sum of cash. These purchases do *not* change the responsibilities of the structured settlement companies: the companies continue to make the same payments over the term of the settlement. They merely send their check to a different address. The amount, timing or duration of the payments do not change at all. According to statistics maintained by the NASP, 88 percent of settlement purchases are partial purchases. In such transactions, only a portion of the settlement is sold and the claimant retains the balance of the periodic payments.

Statistics from one of the largest NASP company members indicate that the average purchased payment amount is $20,406, representing a portion of up to seven years worth of payments. NASP statistics also reveal that the average seller of structured settlement payments is 33 years old, employed, and has an annual household income of nearly $25,000. Over 85 percent of structured settlement claimants are not disabled and are gainfully employed. Thirty-four percent of claimants use the money to buy a home, 31 percent to pay off existing debts or pay educational expenses, and 16 percent to open or expand an existing business. A NASP survey showed that 92 percent of claimants are "satisfied" or "very satisfied" with the refinancing they were able to accomplish with the help of the settlement purchasing industry.

Consumer Protection Concerns

NASP companies comply with a code of ethics that includes consumer protection and suitability standards. NASP members do not conduct transactions with minors, incompetents or their guardians except by court order. They do not conduct transactions with individuals dependent on future periodic payments for medical necessity or with those who are unemployed or unemployable who rely on their payments as the sole source of income. They do not buy payments from individuals with catastrophic or head injuries. All member companies encourage or require individuals to consult with their own legal counsel prior to entering into a funding transaction. Prospective sellers are given amply time and opportunity to secure alternative sources of capital or back out of a transaction.

NASP is committed to ensuring that the consumer receives adequate protection. NASP has worked in various states to advance legislation that requires state courts or court-like proceedings to approve settlement purchases. Such statutes would be greatly strengthened if language could be added to identify which beneficiaries are affected, which courts could approve lump-sum payments, and the standards the court would apply. NASP has prepared model legislation addressing these concerns and is working with several state legislatures to encourage enactment of this legislation.

President's Fiscal Year 2000 Budget Proposal and H.R. 263, "The Structured Settlement Protection Act"

President Clinton's fiscal year 2000 budget contains a proposal that would impose an excise tax on any person acquiring a payment stream under a structured settlement arrangement. The amount of the excise tax would be 40 percent of the difference between (1) the amount paid by the acquirer to the injured person and (2) the undiscounted value of the acquired income stream. The excise tax would not be imposed if the acquisition were pursuant to a court order finding that the extraordinary and unanticipated needs of the original recipient of the payment stream render the acquisition desirable.

H.R. 263 (106th Cong., 1st Sess., introduced by Rep. Clay Shaw (R–FL) and others) provides for a 50 percent tax on the amount equal to the excess of (1) the aggregate undiscounted amount of structured settlement payments being acquired, over (2) the total amount actually paid by the acquirer to the seller.

Presumably these proposals are motivated by the valid concern that individuals who own structured settlements not deplete their assets. NASP members also are concerned about protecting the individual claimants. NASP views an informed consumer as the most appropriate way to prevent any abuses that could otherwise occur. Such legitimate concerns should not, however, permanently lock claimants into inflexible financial arrangements that might be completely inconsistent with a financial situation. Full disclosure of all the terms of a contemplated sale transaction, including discount rates, present values, fees and commissions, as well as representation by counsel, would go far to protecting individual claimants. Ironically, these same claimants do not now have the benefit of this full disclosure when they enter into structured settlements.

There is no question that one of the reasons motivating this Committee to adopt the Periodic Payment Settlement Act of 1982 was that structured settlements are useful in protecting people who cannot protect themselves. Although catastrophic injuries were clearly on everyone's mind when the 1982 Act was adopted, the legislation did not limit structured settlements to the catastrophically injured. In what is perhaps a classic example of the law of unintended consequences, the tax and economic benefits of structured settlements are so valuable that they are now used primarily for non-catastrophic cases. There has been a virtual explosion in their use since 1982. Estimates of annuity premiums received by life insurers from third party (non-affiliated) sources in the United States during the twenty year period shows an increase from $.005 billion in 1976 to $4.0 billion in 1996. When transfers to affiliates are included, this number increases to $10 billion. It defies reality to think that more than a small percentage of these represent people who should be locked into these settlements forever.

The policy considerations that support permitting structured settlements of personal injury claims do not justify preventing each and every claimant from selling all or a portion of his or her future payments. The notion that Congress should preclude claimants from revisiting a decision they may have made years before under entirely different circumstances—after being made aware of all the expenses and other facts, and being properly advised as to the consequences—cannot be defended. Circumstances change, and Congress should make it easy rather than difficult for these individuals to change their financial arrangements accordingly. The secondary market has quite appropriately evolved to fulfill this need.

The assumption that claimants are incapable of making reasoned financial decisions if provided full information is unsupportable. We offer as evidence the hundreds and thousands of satisfied customers of NASP members, many of whom have written to our companies attesting to their satisfaction. Virtually all of these individuals are competent to handle their own financial affairs and do so in all other contexts. NASP members, working together with claimants and their representatives, including counsel in many cases, provide various payment options to suit the needs of interested sellers, understanding the balance between demands for immediate cash and how much should be "held in reserve" for the future. Their decision is not always the correct one, but that cannot be prevented without taking away the individual's freedom to choose.

DISCOUNT RATES

It is often alleged that the discount rates used by structured settlement purchasing companies are too high, and thus financially disadvantaged claimants who sell their rights to a portion of their future payments. That is simply false. At present, the discount rate applied in the overwhelming majority of cases ranges from 16 to 18 percent, no higher than the interest rate charged on credit card balances. In fact, these rates have fallen steadily over the last two years. This reflects the fact that, as the secondary market has grown, more and more competition among settlement purchasing companies has developed. Often, claimants will shop among the companies to maximize the amount of money they receive, thus lowering the discount rate. In addition, one of the factors keeping rates high is the legal impediments raised by opponents of structured settlement purchases. If Congress can further streamline and make clear that sales are permitted under appropriate circumstances, it is a certainty that discount rates will drop substantially. Thus, consumers would be the ultimate beneficiaries from clarification of the tax and other rules that apply when settlements are purchased.

NASP believes that if Congress has concerns about discount rates it should address those concerns in a manner that does not have the effect of raising the cost of the transaction even higher. Imposition of an excise tax would only increase the cost to claimants who chose to engage in a sales transaction. For example, a claimant who desires to sell five years' worth of a settlement (approximately the current average length of payments sold according to NASP statistics) would be forced to sell in excess of eight years' worth in order to receive the same dollar amount if an excise tax became law.

The surest way to increase the amounts provided to the intended beneficiaries is to require adequate consumer protection in all phases of a structured settlement, including the original settlement and the subsequent transfer of payment rights. This would assure that beneficiaries are informed of the values and settlement options at the time of the original settlement so that they would be less likely to enter into settlements that do not meet their needs. Additionally, adequate protection in the form of a "consumer bill of rights" as adopted under the code of ethics by NASP members would help to weed out any unscrupulous refinance companies. Just as in the case of lotteries, consumer protection should include required cooperation between the companies making the settlement payments and any companies involved in transfer of payment rights.

TAX EFFECTS OF THE SALE OF STRUCTURED SETTLEMENT PAYMENTS

Finally let me turn to the Federal income tax issues presented by settlement purchases. Tax issues have been raised by proponents of the legislation before you today. In a nutshell, some assert or at least suggest that there are possible adverse tax consequences if structured settlement payments are sold.

Let me state, in no uncertain terms, that there is no tax issue. The sale of structured settlement payments by a claimant should have *no* adverse tax consequences to any party.

Section 130, which was enacted as part of the 1982 Act, codified IRS ruling practice dating back to the late 1970s. The IRS rulings permitted the use of structured settlements as a vehicle through which a claimant could receive payments over a period of years rather than in a lump sum without adverse tax consequences to either party, so long as the claimant was not considered to be in constructive receipt of those payments. The language appearing in the IRS rulings was copied into the statute, and the legislative history of section 130 reflects that purpose and intent.

The language in the statute prohibits the payments from being "accelerated, deferred, increased or decreased" by the recipient (claimant). Some have argued that this language bars the sale of structured settlement payments because a sale could be viewed as an acceleration. They argue that this language was intended to lock the claimants into their settlements and prohibit them from selling their payments, presumably because these are individuals who are incapable of making decisions on their own.

That is not what the language of section 130 does or was intended to do. First and foremost, there was no *tax policy* reason in 1982 (and there is none today) to encourage structured settlements of claims. As the hearing in 1982 makes clear, the tax policy concerns went the other way—the effect of a structured settlement is to exclude interest income from the taxable income of claimants while granting a full deduction for that same amount to the structured settlement company. In spite of this tax slippage, it was decided (originally by IRS and later by Congress) to adopt tax rules that do not stand in the way of structured settlements.

The principal tax rule that might have impeded structured settlements was the doctrine of constructive receipt. If the claimant was deemed to have constructively received the promised future payments, he or she would owe tax on those sums immediately with no readily available cash to meet that tax obligation. Thus the IRS rulings, and later section 130 of the Code, used language designed to make clear that the terms of any structured settlement avoided constructive receipt when it was created. If constructive receipt was avoided at the outset, it will not reappear.

This language—the claimant could not have the right to "accelerate, defer, increase, or decrease" the payments—is the language of the constructive receipt doctrine. It has no meaning for or impact on a subsequent, independent transaction entered into by the claimant to borrow against or sell future payments. The notion that a sale by a claimant, many years after the fact, could cause the structured settlement company to lose its original benefit under section 130 (or could somehow cause constructive receipt to be revisited) is nonsensical. It cannot be a serious assertion under the tax law as it existed in 1982, or as it exists today.

It might be noted, almost parenthetically, that a sale of a stream of settlement payments would solve, not exacerbate, the tax policy issue that concerned Treasury in 1982. Thus the tax system (and Treasury and IRS) should have absolutely no interest in inhibiting sales of settlement payments.

If there is a policy concern about sales of structured settlement payments, therefore, it is solely a consumer protection concern. It is not a tax policy issue.

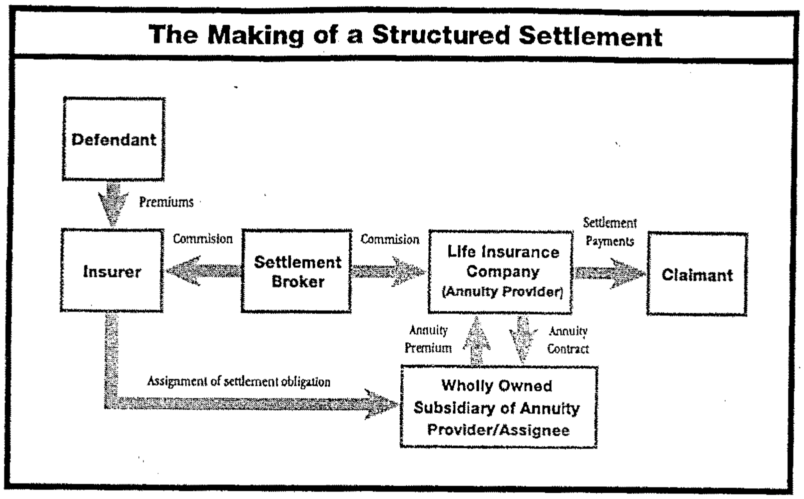
Consistent with this conclusion, it is interesting to note that the IRS has never raised this as an issue. There is no regulation, ruling, notice, or formal or informal pronouncement which indicates the IRS views the sale of settlement payments as raising tax issues under sections 104 or 130. There is no evidence that the IRS has ever raised this issue in any audit. Only one court case has dealt with this issue. The Third Circuit, in a bankruptcy decision, squarely addressed and rejected the argument that a subsequent assignment would cause a settlement company to retroactively lose the income exclusion provided by Section 130. The court went so far as to dismiss the argument as "novel."

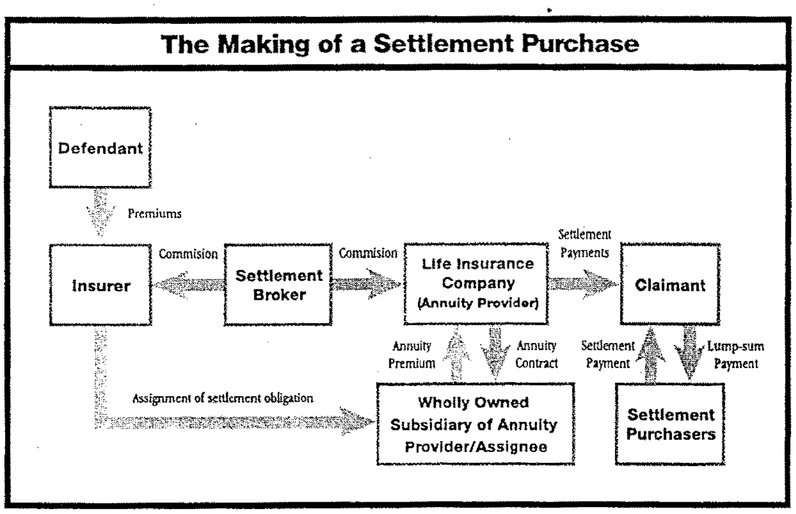
CONCLUSION

Mr. Chairman, the settlement purchasing companies strongly support and actively seek consumer protection legislation to regulate structured settlements and secondary market transactions. Indeed, member companies have been actively working through NASP at the state level to pass such legislation to protect the interests of personal injury victims at the time of settlement and subsequently should they choose to sell a portion of their settlement. It is interesting to note that the Staff of the Joint Committee on Taxation in discussing the arguments for and against the Administration's proposal states "[a]rguably consumer protection and similar regulation is more properly the role of the States than of the Federal government." NASP would welcome adoption of standards to assure the adequate disclosure of present value, fees, and commissions, both at the time that structured settlements are established and at the time of secondary purchase.

I would be pleased to answer your questions.

Attachment


The Making of a Structured Settlement
Defendant
Premiums
Insurer
Commision
Settlement Broker
Commision
Life Insurance Company (Annuity Provider)
Settlement Payments
Claimant
Annuity Premium
Annuity Contract
Assignment of settlement obligation
Wholly Owned Subsidiary of Annuity Provider/Assignee


The Making of a Settlement Purchase
Defendant
Premiums
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Settlement Payments
Claimant
Annuity Premium
Annuity Contract
Settlement Payment
Lump-sum Payment
Assignment of settlement obligation
Wholly Owned Subsidiary of Annuity Provider/Assignee
Settlement Purchasers

Statement of Timothy J. Trankina, Chief Executive Officer, Peachtree Settlement Funding, Atlanta, Georgia; on Behalf of National Association of Settlement Purchasers

Mr. Chairman and Members of the Committee:

My name is Timothy J. Trankina and I am the founder and Chief Executive Officer of Peachtree Settlement Funding (PSF). PSF is a niche finance company specializing in providing liquidity to individuals holding high quality illiquid assets, including structured settlements. I appear before you today along with John E. Chapoton, a partner with the law firm of Vinson & Elkins located here in Washington, and the former Assistant Secretary of Treasury for Tax Policy from 1981 to 1984.

Structured settlement is a term of art used to describe the settlement of a tort claim by way of a series of future installment payments. These payments are made at fixed dates in the future and are often monthly payments or lump sums although virtually any type of payment arrangement can be structured. The use of structured settlements has grown in popularity over the last 15 years as insurers have aggressively marketed them as a cost effective settlement tool. The settling accident victim is often given a choice between a lump sum (for example $100,000) or a series of future payments (e.g. $1,000 per month for 240 months). Since the present value of the future payments is usually not disclosed to the victim, they will often accept the installment payments under the mistaken belief that they are worth more than the lump sum (ie. they believe, wrongly, that $1,000 per month for 240 months is worth $240,000 when in fact it is worth considerably less).

While structured settlements are often very useful as settlement tools, they suffer from one very serious drawback—inflexibility. Thus, several years into a structured settlement payout, a victim's life circumstances will have changed such that they need or desire a lump sum. Settlement Purchasers such as Peachtree fill this void by re-financing a portion of the future payment in order to give the accident victim the lump sum they desire now. Contrary to the message being "spun" by the proponents of the excise tax, on average, we charge discount rates of 18–20% per annum. These rates are consistent with credit cards and other "b" and "c" lenders rates.

As you may or may not know, the National Association of Settlment Purchasers (NASP) is a trade group made up of companies and individual small businesspeople who are involved in the secondary market for structured settlements. NASP members provide liquidity for individuals who are receiving structured settlement payments over a long period of time. This liquidity is provided either by way of a loan, secured by a pledge of the individual's right to receive the structured settlement payments, or by way of an outright assignment of the right to receive the structured settlement payments. While most firms (and all NASP members) already provide financial disclosures and rights of recission in their contracts, settlement purchasers support broad consumer protection legislation to require full and complete disclosure from everyone.

In order to appreciate the complexity of the structured settlement area, I have attached a brief Structured Settlement Overview. NASP and its members have no quarrel with and have in fact supported true consumer protection legislation. However, HR 263 is really a ban of the sale of structured settlements in the guise of a consumer protection bill. The particular shortcomings of the bill can be summarized as follows:

1. Settlements that did not require court approval when they were set up should not require court approval to re-finance.HR 263 imposes needless and burdensome conditions of the rights of an individual to use their money as they see fit. The typical structured settlement claimant is seeking less than $20,000 when they re-finance their settlement with a NASP member. Requiring court approval can easily cost the consumer 10% or more of that sum in attorney's fees and court costs. Moreover, in the three states that require court approval (CT, KY and IL) the insurance industry routinely files 40 and 50 page briefs and objections to the transfers. How could an individual possibly afford to combat the insurance industry in court ??? Succinctly stated, transfer of settlements that were not approved by a court in the first place should not require court approval to re-finance.

2. Sales Shouldn't be Limited to the Desperate and The Needy. This bill would tell the courts that *only* a claimant facing "imminent financial hardship" could sell. In other words, the richest guy in town *can't* negotiate a sale—even *with* court permission; but the fellow who's desperate—who faces "imminent financial hardship"—can. That's discriminatory and arbitrary (and perhaps backward). The court should be asking, "what is in the best interest of the claimant?"

3. Bank Lending Should Be Excluded. The bill was supposed to be about unregulated "factoring" transactions, but by its terms, it also covers *loans* and *bank lend-*

ing. We already have plenty of regulations dealing with lending by banks and finance companies. This will make it difficult (if not impossible) for banks to make secured loans to people who are getting payments like this over time. And it will make it difficult for personal injury law firms to secure affordable credit.

4. Claimants Deserve These Protections Whenever Asked to Choose Between Cash and Payment Over Time. Whenever a personal injury claimant is asked to choose between up-front cash and payment over time, the claimant should be: (1) advised to consult with a lawyer or other professional advisor; (2) told what they are getting and what they are giving up; and (3) told what the interest rate or discounted value is. The disclosures should be made and claimants advised to consult counsel when they are considering a sale *and when getting into a settlement in the first place.* That's only fair. In its current form, this bill will be seen as a one-sided effort to protect insurance companies at claimants' expense, leaving claimants without any meaningful disclosure requirements or safeguards at the "front-end"—and no meaningful opportunity to cash out when and if their circumstances later change.

There is an enormous amount of misinformation, disinformation and demagoguery regarding structured settlement purchasers and the financial terms of the transactions we engage in. Attached as exhibit "B" is a three page document which separates fact from fiction. I have also attached a document entitled "What's this Fight Really All About" and one regarding the "tax issue" as exhibits "C" and "D" respectively. It is also important to note that the individuals with whom we do business are not catastrophically injured. They are normal working people who have a need or desire for a lump sum of money now rather than in the future. The following statistics bear this out:

- More than 85% of structured settlement recipients are not disabled and are gainfully employed.
- 92% of claimants are "satisfied" or "very satisfied" with the re-financing of their settlement which they accomplished with the help of Settlement Purchasers.
- The average person who re-finances a structured settlement is 33 years old, employed with a household income of nearly $25,000.
- More than 50% of structured settlements have a present value of $30,000 or less. (*Source: Best's Review—November 1998*)

In conclusion, Settlement purchasers such as Peachtree provide a valuable financial alternative to thousands of people annually. We encourage and will support meaningful regulation that protects consumers. However, as presently drafted, HR 263 will effectively ban our business. Additionally, it will deny Americans access to a valuable financial alternative. As presently drafted, HR 263 will sacrifice the interests of ordinary Americans on the *alter* of insurance company special interests.

Structured Settlement Overview

Structured settlement is a term of art used to describe the settlement of a tort claim by way of a series of future installment payments. These payments are made at fixed dates in the future and are often monthly payments or lump sums although virtually any type of payment arrangement can be structured. The use of structured settlements has grown in popularity over the last 15 years as insurers have aggressively marketed them as a cost effective settlement tool. The settling accident victim is often given a choice between a lump sum (for example $100,000) or a series of future payments (e.g. $1,000 per month for 240 months).

The National Association of Settlement Purchasers is a trade group made up of companies and individual small businesspeople who are involved in the secondary market for structured settlements. NASP members provide liquidity for individuals who are receiving structured settlement payments over a long period of time. This liquidity is provided either by way of a loan, secured by a pledge of the individual's right to receive the structured settlement payments, or by way of an outright assignment of the right to receive the structured settlement payments. While most firms (and all NASP members) already provide financial disclosures and rights of recission in their contracts, settlement purchasers support broad consumer protection legislation to require full and complete disclosure from everyone.

The National Structured Settlement Trade Association has circulated legislation in the form of a so called model act. This legislation was drafted by the NSSTA, who has vowed to put the settlement purchasers out of business. For your information, the NSSTA is made up of independent brokers and insurance companies who make billions of dollars each year in connection with structured settlements. Estimates of the premiums received each year by insurance companies in connection with the issuance of annuities used to fund structured settlements are between 3 and 5 billion dollars annually. The NSSTA brokers that "consult" with the parties during the settlement negotiations (usually with the defendant, defense counsel and/ or property and casualty insurance carrier for the defendant) and attempt to persuade one or both of the parties to settle the case by way of a structured settlement. They earn commissions and fees from the insurance companies by brokering the purchase of an annuity to fund the payments due and payable under the structured settlement agreement.

I. A TYPICAL STRUCTURED SETTLEMENT.

While structured settlements can take several forms. Below is a brief description of what I would consider to be a typical structured settlement transaction. I've also attached a diagram as Exhibit A that may be helpful.

1. An individual (the "Plaintiff") is involved in, for example, an automobile accident with another individual or company (the "Defendant").

2. The Plaintiff may file a lawsuit against the Defendant or simply file a claim with his own automobile insurance company or against the casualty insurance carrier for the Defendant. (It is important to note that all structured settlements do not necessarily arise from a lawsuit. Often, claims against property and casualty insurance carriers that have not resulted in a lawsuit are resolved by way of a structured settlement. Nevertheless, for purposes of our example, let's assume that the Plaintiff has retained a lawyer and filed a lawsuit against the Defendant.)

3. The Defendant's property and casualty carrier will retain an attorney to provide a defense for the Defendant.

4. As is the case with almost all litigation, the parties agree to settle; in this case let's say they agree to settle by way of a structured settlement.

5. Under a structured settlement agreement, the Defendant will contractually agree to pay the Plaintiff (i) an up front cash payment (which almost always goes to pay the Plaintiff's attorneys fees, court costs, medical expenses, etc.) and (ii) future periodic payments. The future periodic payments may be monthly payments, annual payments, every five years, or any combination of these and more. The available payment options are limited only by the creativity and negotiating skills of the parties. The parties execute a settlement agreement, whereby the Defendant and/ or the Defendant's property and casualty insurance company agree to make the future periodic payments to the Plaintiff in return for a release by the Plaintiff of all claims and causes of action against the Defendant and the Defendant's insurer.

6. Often, the Defendant and/or the Defendant's insurer will execute a Qualified Assignment, whereby the Defendant and/or the Defendant's insurer will assign to a third party (the "Assignment Company") the obligation to make the payments due under the settlement agreement. The Assignment Company is typically, but not always, an affiliate or subsidiary of a large insurance company.

7. Typically, the Qualified Assignment arrangement is contemplated and described in the Settlement Agreement and the Plaintiff contractually agrees to permit the Defendant and/or the Defendant's insurer to assign their obligation to make the future periodic payments due under the Settlement Agreement to the Assignment Company. Often, the Plaintiff actually signs the Qualified Assignment and the Defendant and/or the Defendant's insurer is released from any obligation to make the periodic payments called for by the Settlement Agreement.

8. The Assignment Company will then purchase an annuity from a life insurance company ("Life Insurance Company") to fund its obligations to make the payments due under the Settlement Agreement and/or Qualified Assignment. Often, the Assignment Company purchases the annuity from an affiliated life insurance company. For example, Safeco Assigned Benefits Service Company, an Assignment Company, will often purchase an annuity from Safeco Life Insurance Company to fund its obligations to make structured settlement payments.

9. The Assignment Company is the "owner" of the annuity, Life Insurance Company is the "issuer," and the Plaintiff is identified as the "payee," "annuitant" and/ or "primary beneficiary." The Settlement Agreement often, but not always, will provide that the Assignment Company may, at its option, purchase an annuity from Life Insurance Company to fund the Assignment Company's obligation to make the periodic payments.

10. Life Insurance Company will then make the annuity payments directly to the Plaintiff, as payee, annuitant and/or beneficiary under the annuity, at the direction of the Assignment Company, as owner of the annuity.

11. NASP members come into the equation by providing the Plaintiff (i.e. the (annuitant/payee/beneficiary under the Annuity) liquidity, in the form of assignments or loans secured by the Plaintiff's right to receive all or a portion of the payments due under the Settlement Agreement and annuity. For example, a NASP member

may accept an assignment of the Plaintiff's right to receive certain payments due in connection with the structured settlement arrangement or may loan the Plaintiff money, in return for a pledge of the Plaintiff's right to receive the payments due under the settlement agreement and/or annuity.

This is not the exclusive method by which structured settlements arise, but certainly the most common. For example, there is no requirement that a structured settlement involve an Assignment Company or an annuity. As discussed in more detail below, the Assignment Companies, Life Insurance Companies and structured settlement brokers enjoy tremendous economic benefits from structuring these transactions in the above manner, which helps explain why this structure is so valuable. Nevertheless, defendants in litigation and their property and casualty insurance companies may simply agree with plaintiffs and claimants to settle a case which calls for a payout of the settlement amount over time. That would be considered a structured settlement, but would not involve a Qualified Assignment company and would not fall under Section 130 of the Internal Revenue Code (see below). The defendant or property and casualty carrier may bypass the Assignment Company and simply purchase an annuity directly to fund its obligation under the settlement agreement or simply make the future periodic payments directly to the plaintiff/claimant out of its own funds. Structured settlements that predated 1986 (and the enactment of certain tax provisions) typically did not involve Qualified Assignments.

II. THE TAX CODE.

The structured settlement business generated by the members of the NSSTA exists, almost entirely, because of the presence of two provisions of the Internal Revenue Code. Sections 104 and 130. Section 104 provides that monies received by individuals on account of personal injury, sickness or death is excludable from the gross income of the taxpayer receiving said monies. This exclusion applies whether the monies are received in a lump sum or over a period of time. Hence, monies received under a structured settlement are not taxable to the Plaintiff. This section of the Code dates back to 1939 and is well-established. The exclusion from gross income applies to all monies received as a result of personal injury, sickness or death as long as there was some physical injury.

The other relevant provision of the Internal Revenue Code is Section 130, which conveys certain tax benefits on the insurance companies that enter into structured settlements. This provision was not enacted until 1986 and resulted from intense lobbying by insurance companies and structured settlement companies. It provides that an entity that accepts, by way of a "qualified assignment," the obligation to make structured settlement payments to an injured claimant shall not be taxed on the amount paid to said party by the defendant to assume such obligation, provided that the Assignment Company (i) assumes the liability from a person who was a party to the suit or settlement agreement; (ii) the periodic payments are fixed and determinable as to amount and time of payment; (iii) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of the payments; (iv) the assignee's obligation is no greater than the obligation of the person who assigned the liability; (v) the periodic payments are excludable from the gross income of the recipient under Section 104; and (vi) the amount received by the assignee for assuming the periodic payment obligation is used to purchase a "qualified funding asset." A quailed funding asset is defined as an annuity contract issued by a life insurance company or an obligation of the United States (such as treasury bills). It allows NSSTA broker members to "sell" structured settlements more effectively and amounts to a huge tax benefit for the insurance companies, which own the Qualified Assignment companies.

As a result of Section 130, much of the 5–8 billion dollars received by Assignment Companies each year to assume the obligation of defendants and property and casualty carriers to make the periodic payments due under structured settlements is not taxable to the entities that receive these payments. While it is true that the Assignment Companies use most or all of this money to purchase "qualified funding assets," it is important to note that almost all of these qualified funding assets are purchased from affiliated life insurance companies (parent or sister companies). Thus, the life insurance companies get to sell their annuity products at very competitive rates. For those life insurance companies that own property and casualty companies and also issue annuities to fund structured settlements, the they have a potentially very large and lucrative captive customer.

III. WHO BENEFITS FROM STRUCTURED SETTLEMENTS?

The transaction provides a great many benefits to the players that are not always recognized or appreciated by those unfamiliar with the transaction.

a. It is widely reported that insurance companies (i.e. the property and casualty carriers) are able to settle personal injury claims for 15–20% less than it would typically cost them to settle such claims by way of a cash payment. Benefit to the insurance industry.

b. The plaintiff's lawyer almost always receives their fee up front, out of the cash portion of the settlement; otherwise you can be sure that plaintiff's lawyers would be reluctant to put their clients into structured settlements. Benefit to plaintiff's lawyers.

c. Structured settlement brokers who structure the settlement and place the annuity with the insurance company earn a fee in connection with the transaction. Benefit to structured settlement brokers [i.e. NSSTA members]. (Note: the vast majority of these structured settlement brokers represent the defendant/property and casualty insurance carrier. Thus, their incentive is to settle the case as cheaply as possible for the defendant/insurance carrier, to insure additional business with the casualty carrier.)

d. The Assignment Company receives cash compensation from the defendant/property and casualty carrier for agreeing to assume the obligations to make the future structured settlement payments and said compensation is not taxable. Benefits the Assignment Company.

e. Life Insurance Company gets to sell their annuity policies at very competitive rates. In turn, they put that money to work on investments earning large returns for themselves which far exceed the rate at which the annuities were placed. Benefits Life Insurance Company. (Currently, rates for annuities to fund structured settlement payments are around 5.5 to 6%. It is not difficult to see the large profits the Life Insurance Companies enjoy if they are taking in 4 Billion Dollars per year in annuity premiums that yield [to the Plaintiff} 6% per year and then invest the money and earn a return of 10 % or higher.)

IV. PROBLEMS WITH STRUCTURED SETTLEMENTS.

The problems with structured settlement transaction are as follows:

a. They are inflexible. In order to prevent the claimant from being in "constructive receipt" of the annuity payments, Section 130 of the Internal Revenue Code provides that payments cannot be increased, decreased, accelerated or deferred. Thus, once the Plaintiff agrees to the structured settlement, they are stuck with it. If the Plaintiff has a change in his life circumstances (i.e. death, divorce, serious illness, etc.), which was not (and could not have been) anticipated at the time of the structured settlement, the Plaintiff is unable to access or liquidate his structured settlement payments to address those issues. If the Plaintiff has a financial emergency (i.e. unexpected medical procedure not covered by insurance, bankruptcy, foreclosure, etc.) they would be unable to access their funds to address the emergency. If the Plaintiff wanted to access their structured settlement payments to continue or finish their education; buy, improve, or remodel a home; or start a business; pay off debts; avoid foreclosure or bankruptcy, etc. they are precluded from doing so.

b. Structured settlements require the parties to anticipate far into the future. It is impossible for a Plaintiff and his counsel to look into the future and anticipate, with any degree of certainty, what the person's financial situation and needs will be.

c. No states have regulations requiring disclosure of the terms of the structured settlements, such as the present value of the future payments due under the structured settlement, the discount rate used to calculate the present value, the total amount of payments to be paid (so a comparison can be made of the present value vs. the total future payments), etc. Plaintiffs do not always fully understand the ramifications of a structured settlement and the Defendants and insurance brokers an insurance companies who forge structured settlements on these Plaintiff's and their counsel are not in a big hurry to explain the transaction in its entirety, particularly with respect to the present value of the future payments.

d. Often, structured settlements are negotiated with individuals who are not represented by counsel. That is a particularly true when a person files a claim with their own insurance company. In fact, there are several pending class actions against insurance companies for discouraging their insured's from retaining counsel to represent them in connection with personal injury claims. In fact, in one state one insurance company was cited for practicing law without a license by providing legal advice to claimants regarding their claims. In cases where the Plaintiff is not represented by counsel, the problems caused by the absence of any meaningful regulations requiring disclosure, representation by counsel, etc. when structured settlements are originally proposed are exacerbated.

V. Business Practices of Insurance Companies and Structured Settlement Brokers.

For your information, the structured settlement brokers and insurance companies who make hundreds of millions of dollars per year on structured settlements and who are proposing the legislation to eradicate our business have some skeletons in their own closet.

a. As indicated above, structured settlements have numerous benefits for the property and casualty insurance carrier and defendants who settle litigation with structured settlements (cheaper to settle and a reduction in attorneys fees); the brokers who structure the settlement (they earn a fee for selling the annuity to fund the structured settlement payments); the plaintiff's lawyer (who settles the case without having to go to trial and who receives his/her fee up front, in cash); and the life insurance company/assignment company (who accepts the obligation to make the payments and gets to sell an annuity [they receive cash tax free, sell an annuity at relatively low fixed rate [i.e. currently about 6%], and are able to earn a return on the money they receive for issuing the annuity]).

b. There are few, if any consumer protection regulations imposed on the front end of a structured settlement transaction, such as required disclosures, court approval, mandatory review by an attorney or financial advisor, etc.

c. Insurance companies and structured settlement brokers representing defendants in structured settlement negotiations use questionable practices in trying to persuade defendants to accept structured settlements. For instance:

(i) Travelers Insurance is currently a defendant in a class action case in Connecticut involving claims of fraud, deceptive trade practices, civil conspiracy, breach of fiduciary duty, etc. The plaintiff's class are recipients of structured settlements. The Complaint in that case quotes liberally from Travelers' structured settlement manual as follows:

—"Essentially, when a claimant has a reduced life expectancy and a substandard age rating has been obtained, the more life contingent benefits provided in the structure offer, the higher the savings on the claim."

—"The primary objective in expanding use of structured settlements is to maximize their value as a tool to reduce both claim loss and expense costs."

These quotes from Travelers own manual illustrates the motives of the insurance companies in promoting structured settlements. Moreover, the allegations in the Connecticut class action lawsuit were that Travelers received illegal kickbacks and rebates from structured settlement brokers in exchange for directing business to said brokers. Thus, the structured settlement brokers would rebate part of the commission they earned for arranging a structured settlement through or for Travelers in return for Travelers' agreement to direct business to the brokers who agreed to make such rebates. (It is my understanding that rebating is prohibited by statute in virtually every state in the country.)

(ii) Insurance companies, defendants, and structured settlement brokers endeavor to "back-load" structured settlement contracts and, as evidenced above, increase the life contingent component in the structured settlement agreements. For example, it is not uncommon for structured settlement agreements to call for periodic payments every five (5) years or so to, with the payments increasing substantially toward the end of the agreement. We've seen deals that call for a payment of $ 10,000 in Year 5, $ 15,000 in year 10, $ 25,000 in year 15, $ 50,000 in year 20, $ 100,000 in year 25, and $ 100,000 in year 30. The deal may be "sold" by the defendant, insurance company and/or structured settlement broker as a $ 300,000 settlement (referring to the total amount of payments), yet the true value of these future payments, assuming an 8% discount rate, is around $ 57,000.

—Another example involves an actual structured settlement involving one of our clients in Oregon from 1991. Our customer's parent settled this case when our customer was 16 years old. The settlement documents specifically refer to a settlement of $ 581,173.82, broken down as follows:

• Cash payment of $ 110,443, of which $ 50,136 went to the plaintiff's attorney, $ 41,443 went to reimburse his health insurance company for money paid to medical providers related to the accident, and $ 18,863 was paid to the plaintiff's father to reimburse him for his out-of-pocket medical expenses (probably the deductible) and to replace the plaintiff's car.

• The remaining $470,730.82 was structured over a period of 19 years. The plaintiff was to receive $15,000 in January 1996, when he was 22 years old; $30,000 in January 2003, when he was 29 years old; and $425,730.82 in January 2010, when he was 36 years old. This deal was marketed and sold to the plaintiff and his father as a $581,173.82 settlement. In reality, the settlement resulted in reimbursement of the plaintiff's health insurance provider, a replacement car for the plaintiff, and future payments over a period of 19 years that had a present value, assuming an 8% discount rate, of $ 120,770.

—Other examples involve monthly payments of $ 125 per month, payments every five years of $ 5,000 per year, four annual payments of $ 12,000 each, etc. Claims adjusters and attorneys representing property and casualty carriers will often tell the claimant/plaintiff (particularly when they are not represented by counsel) that the only way the case can be settled is by way of a structured settlement. We are involved in a deal right now, where the plaintiff's attorney has been told point blank by Liberty Mutual that they will not settle his client's case except by way of a structured settlement. They have offered three (3) payments that total approximately $ 16,300, to be paid in the years 2004, 2006, and 2009. The present value of those payments, assuming an 8% discount rate is $ 9,203.

The point of these examples is not that parties should not have the right to settle a claim or case on any terms that they deem appropriate. The point is that the insurance companies and structured settlement brokers often argue, in their ongoing effort to put us out of business, that structured settlements were created to serve important public policies such as to settle cases involving catastrophically injured individuals who have long term and continuing medical needs and physical disabilities with little or no ability to provide for themselves or their families. They contend or imply that structured settlements are used exclusively or mostly where the claimant/plaintiff is disabled and unable to work such that he or she is dependent on the monies he receives under the structured settlement agreement for future medical expenses and to support himself and his family. That simply is not true.

Certainly, there are structured settlements that involve catastrophic injuries. However, for the vast majority of structured settlements the overriding reasons underlying the decision to settle the case by way of a structured settlement are that they are a tool that promotes the settlement of claims and disputes because (I) the defendant and/or casualty carrier can settle the claim for less money than if it was settled by way of a structured settlement; (ii) the structured settlement broker earns a fee, (iii) the life insurance company is able to sell an annuity; and (iv) the plaintiff and the plaintiff's counsel are able to avoid a lengthy and expensive trial and resolve their dispute. There is nothing wrong with these reasons underlying structured settlements, but it is disingenuous for our opponents to suggest that these are not important reasons underlying the use of structured settlements. Furthermore, any suggestion by the opposition that all (or even a majority) of structured settlements involve individuals who have sustained catastrophic injuries which require long-term care is simply inaccurate, deceptive, and misleading. Remember, these insurance companies that have suddenly developed this pro-consumer interest in preserving and protecting the long term well-being of these injured claimants are, in many cases, the same people who tried like heck to defeat the claimants in court. Since when were insurance companies the bastion of consumer protection?

d. Another argument that the insurance companies and structured settlement brokers advance in support of their efforts to shut down our business are as follows:

• structured settlement recipients are unsophisticated in financial matters and by structuring the settlement so as to spread the payments over time, the recipients will not receive a large lump sum which they are likely to dissipate prematurely, leaving them and their family destitute, unable to work, and a ward of the state.

Response: This argument presumes that all structured settlement recipients are unsophisticated in financial matters and will prematurely dissipate a cash settlement. Not true. Occasionally, the settlement agreement provides that the plaintiff's attorney shall receive their fee over time as part of the structured settlement. (That does not happen too often, because attorneys appreciate the time value of money.) There simply is no correlation between being unsophisticated in financial matters and being the recipient of a structured settlement, unless one were to assume that someone who was unsophisticated in financial matters would be more likely to accept a structured settlement in the first place instead of a cash settlement. If that were true, then it would seem to me that these transactions cry out for some basic consumer protection and disclosure regulations on the front end. If structured settlement recipients are so unsophisticated in financial matters and so seriously injured, as our opposition claims, what is so wrong with requiring the insurance companies and structured settlement brokers who sell these products, which call for payments to people 20, 30, 40, even 50 years down the road, to provide some basic information about these structured settlements. (Insurance companies can and do go broke.) One could argue that an injured claimant deserves and needs more information about structured settlements on the front end, when they are considering releasing their claim in return for the unsecured promise of future payments that may come due far out in the future, than they need on the back end, when deciding to assign five or six years of payments in order to address an immediate need or when they desire to pledge their right to receive said payments as collateral for a small personal loan. Yet, the insurance industry opposes *all* suggestions for basic disclosures to be provided claimants when faced with the decision of accepting a structured settlement.

The vast majority of structured settlements involve accidents where the claimant/plaintiff did not sustain catastrophic or permanent injuries and/or where the plaintiff has recovered from their injuries. (NASP members typically do not enter into transactions with individuals who are both unemployed *and* unemployable.) In addition, structured settlements are often used to settle wrongful death cases (where the recipient of the payments is not the person who was physically injured). I've even seen cases where a structured settlement was used to resolve a same sex sexual harassment case.

Furthermore, simply because the person sustained serious or permanent injuries does not necessarily mean: (I) that they cannot lead a productive life; (ii) that they cannot provide for themselves and/or their family; (iii) that they are unsophisticated in financial matters; (iv) that they received a large structured settlement that was designed to provide for them for the rest of their life; or (v) that they would not benefit from having the opportunity to assign or pledge all or a portion of their right to receive structured settlement payments to address a personal need, situation or emergency. Some examples:

- We closed a transaction with a young man in Arizona who had sustained a spinal injury that left him a paraplegic. Because of the nature of the accident (i.e. no liability by the defendant and/or the defendant who was liable had no money and/or the plaintiff was partially at fault) this person's structured settlement was rather small (the original settlement called for $ 15,000 per year for 10 years). However, this young man was self-sufficient and able to work. He was completing his education and preparing to take the CPA exam. He wanted some money to purchase a new handicapped van, complete his education, and prepare for a new job. He had four (4) annual payments remaining and assigned them to us for a lump sum payment of around $ 41,000.
- Another gentlemen who was our customer had sustained serious injuries and was physically disabled. He desired to put a down payment on a house and do some work on it to make it handicapped accessible. He also wanted to purchase a handicapped van. Although this gentleman had not fully recovered from his injuries, such that he could hold down a full time job, he was working toward that goal. His immediate objective was to gain some independence by purchasing his own home and transportation. (Previously, he had been living with his parents.) He was receiving over $ 7,500 per month from his structured settlement, which was increasing 3% per year. He wanted to assign $ 1500 per month for 8 years so that he could raise funds to start these projects. He was represented by counsel throughout the process and was very much in favor of proceeding with the transaction. Without the option to complete a transaction with Settlement Capital, this fellow would have had no other alternative.
- There are numerous examples. We completed a transaction with a gentlemen who wanted to purchase a mobile home park. (He had recovered from his injuries and was working, but wanted to go into business for himself.) We completed a transaction with a lady who was working for AT&T and making $ 52,000 per year, but wanted to raise some money to send her daughter to Tulsa University. We loaned her $ 16,000, secured by her structured settlement payments. Another client was about to get married and she and her fiancee had saved approximately $ 15,000 for her wedding. A few weeks prior to the wedding, there was an unexpected death in her family. She had to use the money for her wedding to pay for the funeral. Her parents had settled a case for her when she was a child and she was scheduled to receive a $ 30,000 payment in approximately two (2) years. She was able to assign that payment to us and use the proceeds for her wedding. She was neither disabled nor unsophisticated. Everyone in our industry has been able to complete transactions with individuals to help them purchase a house, improve their home, start a business, continue their education, avoid foreclosure or bankruptcy, consolidate debts, pay off tax liens and child-support obligations, etc. The list is endless.

Query: If the insurance companies and structured settlement brokers are so concerned about the welfare of the structured settlement recipient, why do they back-load their structured settlement agreements and push life contingency payments. If they are concerned about the claimant dissipating large settlements, why do they back-load their deals with huge lump sum payments far in the future (i.e. $ 500,000 due in 2012, $ 1,000,000 due in 2020, etc.). Why do the news letters of the structured settlement brokers and NSSTA members emphasize selling the "gross value" and “aggregate total value of the payments” in settlement negotiations? In an article in a recent NSSTA newsletter, addressing overcoming objections to structures, the emphasis was on the use of “gross dollars” to compare a structure to a cash offer. Why won’t they support legislation that requires that a person consult with counsel prior to entering into a structured settlement? The answer is that they want to destroy our business and continue to operate their business in a manner that maximizes their ability to place structured settlements and earn billions of dollars, while denying the consumer the right to make an informed choice or have control of their financial future.

• In a public hearing before the Texas State Senate Judiciary Committee in Texas in April of last year, a structured settlement broker and member of the NSSTA testified that there was not enough disclosure and information provided to the plaintiff in structured settlement negotiations. He testified that too often the property and casualty insurance carrier who has insured the defendant insists on placing the annuity to fund the structured settlement with an affiliated life company, even though another life company is offering a better rate and even though doing so might not be as beneficial to the claimant. He cited an example involving one case in which he was involved where the cost of the “in-house” annuity was $ 350,000 and a competing offer was around $ 260,000. (The point was if the property and casualty carrier was willing to purchase an annuity from its own affiliate for $ 350,000, they should have been willing to pay the same to another life insurance company, meaning the claimant/plaintiff could have received more structured settlement payments for the same cost from another independent life company.) He commented that some structured settlement brokers are only licensed by certain life companies, meaning any structured settlements involving said brokers would necessarily be placed with the life companies with which the broker was licensed, regardless of the benefits to the claimant/plaintiff. Other property and casualty companies have an approved list of companies with whom they will do business, further limiting the choices of the consumer. He also commented on problems with rate and age adjustments in connection with structured settlements. Finally, and perhaps most importantly, he complained about the practice of “rebating” which he stated was not uncommon in the structured settlement industry. He said that this practice never benefits the consumer. He concluded by saying that any legislation that requires disclosure and more information to be provided to the injured claimant and his attorney would be a positive development. Remember all of these comments were made by a structured settlement broker and member of the NSSTA in a public hearing and under oath. His statements closely followed the allegations asserted against Travelers in the Connecticut class action cases.

In short, the insurance industry, NSSTA, and structured settlement brokers preach consumer protection and public policy in their efforts to discredit and destroy our industry, while ignoring their own problems and resisting any efforts to address and/or regulate their industry. Contrary to their stated positions, their true interest is to expand their market and continue to earn billions of dollars without being subject to disclosure requirements and other consumer protection provisions and regulation and without the presence of the secondary market to educate the public or otherwise challenge them. (Remember, none of their proposed legislation imposes any regulation on them and, most notably, does not apply to a commutation of the future benefits due under the structured settlement to the Plaintiff by the Assignment Company and/or Life Insurance Company. In other words, we would be subject to extremely onerous disclosure and court order provisions to complete our transactions with our customers, while they would not be subject to such requirements, meaning they would have a substantial competitive advantage in completing such transactions. Sounds like a legislative monopoly to me.)

VI. Why the NSSTA, Structured Settlement Brokers, and the Insurance Industry Wish To Destroy Us.

There is no simple answer to this question. They will tell you that secondary market transactions threaten the tax benefits which structured settlement recipients and the parties obligated to make structured settlement payments enjoy under the Internal Revenue Code. That is, I believe, a red herring. There is no reported case, rule, regulation, IRS ruling or other authority that supports their contention that these transactions threaten their tax status. In fact, the only case to address the matter was a Third Circuit case, which rejected this proposition.

They will, of course, argue consumer protection and claim that the secondary market is ripping off consumers and charging exorbitant and unconscionable discount rates. That is also untrue. While discount rates are high, relative to mortgage rates and the prime rate, they are in line with credit card rates and other relatively risky lending. Discount rates range from 12% to as high as 25%, but the vast majority of deals are completed in the range of 16% to 22%. To be absolutely fair and frank, there certainly are some transactions where the discount rate exceeds 25%, rising to 30 or even 35%, but those involve very short and small transactions. (For example, someone may be scheduled to receive 2 annual $ 5,000 payments over the next two years and seek to raise some cash now. Our industry members do have a cost of capital [maybe 7,8, 9, or 10%], therefore to make the transaction economical, the annuitant might receive $ 6,700 at a discount rate of 31.41%. While that rate might seem a bit high, compared to the prime rate of interest, the fact is that our customers do not have access to traditional sources of capital. Moreover, the actual dollar difference between a rate of say 21.5%, which you might be able to get on a credit card and the 31.41% rate, would be $ 800. When you are dealing with transactions this small and this short-term, the actual dollars is what is important. Due to the risk inherent in our transactions and the cost of bringing in a transaction, we simply cannot do deals this size at these types of rates.)

Our opposition often argues that our customers receive 10 or 20 cents on the dollar. In this particular case, while the rate is relatively high, the annuitant receives 68 cents on the dollar. In a longer term transaction, say a $ 25,000 payment due in five years, the transaction could be completed at a rate of 15.5% and the annuitant would receive less than 50 cents on the dollar. The point is that you must be careful when comparing transactions, interest rates, and dollar amounts. You must not compare apples to oranges.

It is important to note, however, that when these transactions are completed by way of a loan, as some NASP members do, they are bound by usury limits. In Texas, the usury limit is an 18% effective rate, which means that our transactions are completed at a contract rate of interest of around 16.5%. Furthermore, lenders are required to provide disclosures of effective interest rates, etc. as required under applicable state law and the Federal Truth-in-Lending laws, may not charge fees or points, and must allow pre-payment of the loan without penalty.

All NASP members would support regulation of our industry which would require disclosures, that the seller/borrower be represented by counsel, and other consumer protection provisions. I believe NASP would also support a reasonable court/administrative agency review process, as long as the procedure was not too expensive and time consuming for the borrower/seller and as long as the standards of review were reasonable. In short, we support true “consumer protection” regulation, but not laws that give the insurance industry control over our customers and our business and which, in effect, regulate us out of business.

I believe the true motivation behind the insurance industries’ opposition to our business is that by virtue of the fact that we exist, we necessarily educate the public and plaintiff’s attorneys as to the true value of structured settlements, which is something our opponents cannot accept. We also have raised the profile of their industry and highlighted the profits they are earning and the tax boondoggle that they enjoy in Congress. A representative of the NSSTA once said to me that they have been told by their leadership that they must destroy us or we will destroy them. While I disagree with that statement, the fact that that is how they feel should give you some insight as to why they are fighting us.

We happen to believe our arguments are compelling and our position is reasonable and makes sense. However, we recognize that our opponents have done a good job of painting us as immoral companies who prey on widows, orphans, and the weak and uninformed. That simply is not true. Our objective is to survive and thrive in a reasonably regulated industry.

What are Structured Settlements Really About ???

On August 12, 1998, a hearing was held in the Circuit Court for Montgomery County, Maryland in the matter of *Stone Street Capital v. Deborah L. Jackson*, Civil No. 176131. In this hearing, Counsel for State Farm Insurance company discussed the reasons for pursuing structured settlements in personal injury case. Following is an excerpt from the transcript on this hearing:

THE COURT: Why is it, by the way, that traditionally these [structured settlement annuity contracts] are non-assignable?

COUNSEL FOR STATE FARM: There are a lot of reasons. One is to protect the victim usually of personal injury. The whole reason for setting up these—

THE COURT: Protect them from what?

COUNSEL FOR STATE FARM: The whole reason for setting up these structured payments is so that they do not get a lump sum; they do not get $300,000 up front. These people—

THE COURT: No it is not. The reason for setting up these structured payments are so that the insurance companies can settle out cheaper.

COUNSEL FOR STATE FARM: That is one reason

THE COURT: All right, come on—

COUNSEL FOR STATE FARM: I am not going to deny that.

THE COURT: They are not looking out for a plaintiff in a personal injury case. Please.

COUNSEL FOR STATE FARM: That is one reason that Your Honor has said. It is more cost effective for the insurance company—

THE COURT: That is the reason. That is the reason.

COUNSEL FOR STATE FARM: Okay.

How Insurers Abuse Structured Settlements

The attached are examples of structured settlements. These example show how, when they are being set up, the insurance industry abuses them and how the true economics of a structured settlement are buried, hidden and obscured to make them seem more appealing to the plaintiff lawyer and his client.[1]

EXHIBIT: EXPLANATION/COMMENTS:

1. Examples of actual insurance company settlement documents showing the amount they paid for the annuity and the future value of the settlement. This is why structured settlements "seem" like a great deal for the claimant when they are really a great deal for the insurer.
2. Attorney accidentally took his fee on the *future value* of the settlement.
3. Christy's proposal states that the value of the settlement is $222,000. In fact discounted at 10% it is really worth only $140,000 an overstatement of more than 58%!
4. The proposal for Rose states that the value of $630.89 per month for 240 months is $151,413. Discounted to present value at 10% per annum it is only worth $63,000—an overstatement of the value of more than 140% !!
5. The Mr. & Mrs. Gibbons settlement proposal says that they are guaranteed $830,000. However, the real economic value of the guaranteed portion of the settlement is half that amount!!!
6. This settlement agreement wrongly sets forth the settlement values suggesting that the client is settling for over $413,000 when in fact the settlement is a mere $129,000.
7. The settlement foisted on this 19 year old accident victim tells her the settlement is worth $1,594,918 when in fact, it is only worth $341,166 in present value—this settlement proposal overstates the true value of the settlement by an astounding 367.4 %!!!
8. The settlement proposal for Kimberly sets out the actual cost of the annuities being purchased. With this information we can see that the yield she is receiving on the annuities purchased is a miserly 3.452% for the monthly annuity and 4.253% for the one paying the lump sum whereas, in 1993, United States Treasury Bonds were yielding over 7%.
9. Here again, due to lack of information, the attorney over-charged his client by taking a fee on the entire future value of the settlement.
10. This comparison is so utterly misleading and incorrect as to need almost no commentary. First, yields on U.S. Treasury securities at the time (7/'93) were over 7%. Thus, the annual payment would have been closer to $46,800. Second, the tax code specifically allows one to fund a structured settlement with U.S. Govt. securities—thus there would be no taxes due! Third, A U.S. Govt. bond is risk free whereas, a commercial annuity has default risk (see First Executive Life, Mutual Benefit Life, Confederation Life, etc.).
11. As a result of the death of her father, a structured settlement was used to provide for the care of Bobbyjo Plank (12 years old at the time). It provides her monthly payments of $2,250. However, they don't start until 43 years latter !!! The true value of this settlement discounted at a mere 5% is less than $64,000. How, pray tell, was this structured settlement designed to care for her???

[1] Over 20% of all structured settlements involve clients with no attorney representation!

More examples available upon request.

PEOPLE WITH STRUCTURED SETTLEMENTS NEED PROTECTION, ALL RIGHT FROM THE INSURANCE COMPANIES!

You may have heard talk about how people who have been awarded structured settlements as compensation for some injury need protection from settlement purchasers. They say these helpless people—who have been crippled or maimed and who rely on their settlement payments for sustenance—are being preyed upon by unscrupulous businessmen who want to dupe them into selling these lifelines for only a tiny fraction of what they're worth. Through H.R.4314, which was introduced at the end of July, they are demanding that a 50 percent excise tax be imposed on such transactions to drive settlement purchasing companies out of business and prevent recipients from "foolishly" dissipating their awards.

Nonsense. The facts tell a much different story. Not only is the vast majority of people who have sold their structured payments for a lump sum not disabled, but as we'll see, they're happy with the choices they have made. Speaking of choices, other facts suggest that the insurance companies who are behind these structured settlements in the first place have not always been up-front with recipients, and have kept some pretty important information to themselves. Maybe that's why they're working so hard to keep exclusive control over this industry.

Let's look at the facts:

- Nearly a third (32 percent) of recipients were not allowed to choose for themselves whether or not they wanted a structured settlement instead of a lump some. Some of these were minors at the time their cases were settled, and in some cases the insurance carrier made a "take it or leave it" offer.
- Almost half the time (48 percent), the actual mathematical value (called present value) of the settlement was not explained to the claimant.
- Almost as often (43 percent of the cases), claimants were not advised that their future scheduled payments were absolutely inflexible.
- Astoundingly, 12 percent of structured settlement recipients were not represented by counsel when they agreed to the settlement.

So it appears that the insurance companies have a lot of explaining to do. But what about their claims that they're now just trying to help protect defenseless recipients.

Again, let's look at the facts:

- More than 85 percent of structured settlement recipients are gainfully employed and suffer no long term disability. *(So much for preying on the defenseless!)*
- 34 percent of those who exchange their settlements for lump sums use the proceeds to buy or renovate a home, 31 percent pay off debts or pay for educational/vocational education, 9 percent use the proceeds for a medical procedure or existing medical bills, 16 percent use the funds to open or expand a business. *(So much for frivolously dissipating their awards!)*
- 92 percent are "satisfied" or "very satisfied" with the refinancing they were able to accomplish with the help of the settlement purchasing industry. (So much for supposedly shady tactics!)
- The average discount rate charged by settlement purchasers is 18–22 percent—about the rate credit cards charge. *(So much for outrageous interest rates!)*

Bottom Line, the facts simply aren't what the insurance companies would have you believe. If you really want to help injured people who have been awarded structured settlements, take your time and demand a carefully crafted consumer protection bill that mandates full and understandable disclosure of financial details at every stage in the process—beginning when settlements are first agreed to, and continuing through any future transfer—and also recognizes the right of recipients to change their minds as their needs and circumstances change and to choose to sell their annuity payments for a lump sum if that's what they want.

WHY WON'T THE BIG INSURANCE COMPANIES TELL THE TRUTH ABOUT STRUCTURED SETTLEMENTS?

There's been talk recently about how Congress ought to impose an extreme new 50 percent excise tax on settlement purchasing companies in order to protect people who have been awarded structured settlements. The big insurance companies who support this scheme, known as H.R. 263, have created a string of myths in their rush to ram this unfair tax through. The problem is, their myths don't hold up in the light of day. Let's look at those myths and the facts they leave out:

Myth: Structured settlements are essential for the long-term financial health of seriously injured people.

Truth: More than 85 percent of people receiving structured settlements have full-time jobs or are capable of working. They don't suffer from long-term disabilities.

The average size of a structured settlement is only $75,000—not nearly enough to pay for the long-term care of someone who's been critically injured.

Myth: People who sell some or all of their structured settlements just squander the money, like the woman who allegedly wanted to cash in her settlement to help her new boyfriend buy a new motorcycle.

Truth: Far from squandering the money, of the people who exchange their monthly payments for lump sums:

- 34 percent use the money to buy or renovate a home.
- 31 percent pay off existing debts and child support obligations. In fact, settlement purchasers require that tax liens, child support and alimony are paid as part of their contracts.
- 14 percent pay medical expenses.
- 11 percent open or expand a business.

Myth: Structured settlements were designed to prevent people from quickly dissipating their awards. Truth: The real reason the big insurance companies push structured settlements is their incredible profitability. Consider this, from The Travelers Structured Settlements Manual:

> The primary objective in expanding the use of structured settlements is to maximize their value as a tool to reduce both claim loss and expense costs."
>
> "Essentially, when a claimant has a reduced life expectancy and a substandard rating has been obtained, the more life contingent benefits provided in the structured offer, the higher the savings on the claim."

In other words, the sooner a person with a structured settlement dies, the less the insurance company has to pay. That's why they're pushing structured settlements—not some altruistic desire to protect people from themselves. Why won't the big insurance companies tell the truth? They can't afford to. Don't let them use Congress to put an entire industry out of business.

[Additional attachments are being retained in the Committee files.]

Chairman HOUGHTON. Thanks very much, Mr. Chapoton.

Mr. Little.

STATEMENT OF THOMAS W. LITTLE, PRESIDENT, LITTLE, MEYERS, GARRETSON & ASSOCIATES, CINCINNATI, OHIO; ON BEHALF OF NATIONAL STRUCTURED SETTLEMENTS TRADE ASSOCIATION

Mr. LITTLE. Mr. Chairman, Members of the Subcommittee, good afternoon. My name is Thomas Little. I am a structured settlement broker from Cincinnati, Ohio. I am testifying today as past president of the National Structured Settlement Trade Association, NSSTA. NSSTA is an association composed of more than 500 members which negotiate and fund structured settlements involving persons with serious, long-term physical injuries.

Structured settlements were developed because of the pitfalls associated with the traditional lump-sum form of recovery in serious personal injury cases, where all too often, a lump sum meant to last for decades or a lifetime swiftly eroded away, and victims were left unable to meet their ongoing medical and living expenses.

Over the past two decades, structured settlements have proven to be a very effective means of providing long-term financial protection to persons with serious long-term, often profoundly disabling injuries. A voluntary agreement is reached between the parties generally through counsel under which the injured victim receives damages in the form of an insured stream of payments, often for the rest of the victim's life. This payment stream is tailored to the day-to-day living expenses and the future medical and financial needs of the victim and the victim's family, and comes from a financially secure institution. The victim has a choice whether to take a structured settlement, and generally only about one-third of the victims who are offered a structure take it.

As a structured settlement broker, I sit at the settlement table with the injured victim and a defense, and work with the parties to try to reach a fair resolution that meets the victim's needs. In my 19 years in the field, I have seen first hand how a structured settlement enables seriously injured victims and their families to put their lives back together and move forward. Structured settlements have the strong support of the plaintiffs bar, the defense bar, judges, and mediators.

Congress has adopted special tax rules to encourage and govern the use of structured settlements in order to provide long-term financial security for injured victims and their families. Under these rules, structured settlement payments are supposed to be nonassignable. However, all of this careful planning and long-term financial security for the victim and the family can be unraveled in an instant by a factoring company offering to buy future structured settlement payments for quick cash at a steep discount. Having factored away their assured source of future financial support, these injured victims are likely to face uncertain financial futures. They may find themselves in the very predicament that the structured settlement was used to avoid, and may now have to resort to taxpayer-financed assistance programs to meet basic needs.

We in the structured settlement industry are here today because we are trying to do the right thing. We are on the frontlines. We see what is happening out there. We see the human cost when factoring companies unravel the structured settlements of injured victims. Court records from across the country tell the story. There is a quadriplegic in Oklahoma, another in California, the paraplegic in Texas, the victim in Connecticut with traumatic brain injuries dating from childhood, and the injured worker who was receiving worker's compensation benefits in Mississippi, all selling their future payments to the factoring companies.

Having worked with this Subcommittee and the Congress over the last two decades to encourage the use of structured settlements, we felt a responsibility to step forward and alert Congress and the Treasury about what is going on about how the congressional policy is being undermined. H.R. 263 represents a balanced approach to these problems created by structured settlement factoring. H.R. 263 imposes a stringent penalty tax on a factoring company that purchases structured settlement payments from an injured victim. The penalty would be subject to an exception for genuine court-approved hardship to protect instances of true hardship of the victim or the family. This is a penalty to discourage a transaction that thwarts congressional policy. It is not a new tax or a tax increase.

H.R. 263 has broad bipartisan support among Members of the Ways and Means Committee and the Senate Finance Committee. It is endorsed by the National Spinal Cord Injury Association and the National Organization on Disability. It is supported by the Treasury. It should be enacted as soon as possible.

Thank you, Mr. Chairman, for the opportunity to testify.

[The prepared statement follows:]

Statement of Thomas W. Little, President, Little, Meyers, Garretson & Associates, Cincinnati, Ohio; on Behalf of National Structured Settlements Trade Association

Mr. Chairman, my name is Thomas W. Little. I am President of Little, Meyers, Garretson & Associates, a structured settlement broker firm headquartered in Cincinnati, Ohio. I am testifying today as Past President of the National Structured Settlements Trade Association.

I. BACKGROUND AND POLICY OF THE STRUCTURED SETTLEMENT TAX RULES

The National Structured Settlements Trade Association (NSSTA) is an organization composed of more than 500 members which negotiate and fund structured settlements of tort and worker's compensation claims involving persons with serious, long-term physical injuries. Structured settlements provide the injured victim with the financial security of an assured payout over time. Founded in 1986, NSSTA's mission is to advance the use of structured settlements as a means of resolving physical injury claims.

A. *Background*

- Structured settlements in wide use today *to resolve physical injury claims*

Structured settlements are used to compensate seriously-injured, often profoundly disabled, victims of torts and workplace accidents. A lump sum recovery used to be the standard in personal injury cases. The injured victim then faced the daunting challenge of managing a large lump sum to cover substantial ongoing medical and living expenses for decades, even for a life-time. All too often, this lump sum swiftly eroded away. When the money was gone, the victim was left still disabled and still unable to work. In such cases, responsibility to care for this disabled person fell to the State Medicaid system and public assistance system.

Structured settlements provide a better approach. A voluntary agreement is reached between the parties generally through their counsel under which the injured victim receives damages in the form of a stream of periodic payments tailored to the future medical expenses and basic living needs of the victim and his or her family from a well-capitalized, financially-secure institution. This process may be overseen by a court, particularly in minor's cases. Often this payment stream is for the rest of the victim's life to make sure that future medical expenses and the family's basic living needs will be met, and that the victim will not outlive his or her compensation.

These are voluntary arrangements. The injured victim has a choice whether or not to take a structured settlement, and generally about a third of the injured victims who are offered a structured settlement take it. The other two-thirds take the cash lump sum.

A recent study underscores the fact that structured settlements typically are used in the case of major physical injuries "when the loss payments are very large." ("Closed Claim Survey for Commercial General Liability: Survey Results, 1997," p. 22, prepared by ISO DATA, Inc., a nonprofit arm of the Insurance Services Office, Inc., which conducted the survey under the auspices of the National Association of Insurance Commissioners (NAIC), the national group of the State insurance regulators).

The ISO study found that of the 215 claims involving structured settlements in the survey sample, 67% arose from "major injuries" ("permanent significant," "permanent major," "permanent grave," death and "temporary major"), with an average total payment of $408,000. The remaining 33% of claims involving structured settlements had an average total payment of $210,000. "Total payment" for this purpose means in effect the total present value of the settlement, and consists of (i) the lump sum of cash paid at settlement, plus (ii) the present value of the future structured payments. The ISO study found that about half of the present value of the case was paid in an upfront lump sum to meet the victim's cash needs (e.g., retrofitting the house for wheelchair access), and the remaining half represented the present value of the structured future payments. (ISO Study, at p. 22). Overall, the ISO study found that the average total present value (including the upfront cash and the present value of the future payments) of a case resolved by structured settlement was $343,000. (ISO Study, at p. 21).

Structured settlements have the strong support of the plaintiff's bar, the defense bar, judges, and mediators.

• Structured settlements provide crucial *financial protection to seriously-injured tort victims*

• Protection against premature dissipation by injured victims lacking the experience to manage the financial responsibilities and risks of investing a large lump sum to cover a substantial, ongoing stream of medical and basic living expenses for a lengthy period.

• Payout tailored to the day-to-day living expenses and the ongoing medical and financial needs of the victim and his or her family.

• Avoids shift of responsibility for care to the taxpayer-financed social safety net.

• Congress has adopted special tax rules to *encourage and govern structured settlements*

Congress has adopted a series of special rules in sections 130, 104, 461(h), and 72 of the Internal Revenue Code to govern the use of structured settlements by providing that the full amount of the periodic payments constitutes tax-free damages to the victim and that the liability to make the periodic payments to the victim may be assigned to a structured settlement assignment company that will use a financially-secure annuity to fund the damage payments.

In the Taxpayer Relief Act of 1997, in a provision co-sponsored by a majority of the House Ways and Means Committee, Congress recently extended the structured settlement tax rules to worker's compensation to cover physical injuries suffered in the workplace.

B. *Structured Settlement Tax Rules Were Adopted by Congress to Protect Victims from Pressure to Dissipate Their Recoveries*

In introducing the 1981 legislation that originally enacted the structured settlement tax rules, Sen. Max Baucus (D–Mont.) pointed to the concern over squandering of a lump sum recovery by injured tort victims or their families:

> "In the past, these awards have typically been paid by defendants to successful plaintiffs in the form of a single payment settlement. This approach has proven unsatisfactory, however, in many cases because it assumes that injured parties will wisely manage large sums of money so as to provide for their lifetime needs. In fact, many of these successful litigants, particularly minors, have dissipated their awards in a few years and are then without means of support."

[*Congressional Record* (daily ed.) 12/10/81, at S15005.]

By contrast, Sen. Baucus noted: "Periodic payments settlements, on the other hand, provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards." (*Id.*)

In introducing legislation last year to protect structured settlements and injured victims from the practice of factoring, Sen. Baucus reiterated this original legislative intent:

> "Thus, our focus in enacting these tax rules in sections 104(a)(2) and 130 of the Internal Revenue Code was to encourage and govern the use of structured settlements in order to provide long-term financial security to seriously injured victims and their families and to insulate them from pressures to squander their awards."

[*Congressional Record* (daily ed.) 10/5/98, at S11499.]

Therefore, the federal tax rules adopted by Congress to govern structured settlements reflect a policy of insulating injured victims and their families from pressures to dissipate their awards.

In addition, Congress was concerned that the injured victim not have the ability to exercise such control over the periodic payments that he or she would be deemed to have received a lump sum recovery that was then invested on his or her behalf, destroying the fully tax-free nature of the periodic payments to the injured victim. The House Ways and Means and Senate Finance Committee Reports adopting the structured settlement tax rules both state: "Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments.” (H.R. Rep. No. 97–832, 97th Cong., 2d Sess. (1982), 4; Sen. Rep. No. 97–646, 97th Cong., 2d Sess. (1982), 4.)

Reflecting this Congressional policy of protecting injured victims from pressure to squander their recoveries and the need to avoid any risk of constructive receipt of a lump sum by the victim, the structured settlement tax rules prohibit the victim from being able to accelerate, defer, increase, or decrease the periodic payments. (I.R.C. § 130(c)(2)(B)). In addition, the periodic payments must constitute tax-free damages in the hands of the recipient. (I.R.C. § 130(c)(2)(D)).

In compliance with these Congressional requirements and consistent with State insurance and exemption statutes, including “spendthrift” statutes that restrict alienation of rights to payments under annuities and under various types of claims (*e.g.,* worker’s compensation and wrongful death claims), structured settlement agreements customarily provide that the periodic payments to be rendered to the injured victim may not be accelerated, deferred, increased or decreased, anticipated, sold, assigned, pledged, or encumbered by the victim.

As the Treasury Department has noted, “Consistent with the condition that the injured person not be able to accelerate, defer, increase or decrease the periodic payments, [structured settlement] agreements with injured persons uniformly contain anti-assignment clauses.” (U.S. Department of the Treasury, *General Explanations of the Administration’s Revenue Proposals* (Feb. 1999), at p. 192).

Sen. John Chafee (R–R.I.), in introducing along with Sen. Baucus recent legislation to protect structured settlements and injured victims from the practice of factoring observed: “Structured settlement payments are nonassignable. This is consistent with worker’s compensation payments and various types of Federal disability payments which also are nonassignable under applicable law. In each case, this is done to preserve the injured person’s long-term financial security.” (*Congressional Record* (daily ed.), 10/2/98, at S11340).

II. Purchases of Future Structured Settlement Payments by Factoring Companies Directly Undermine the Important Public Policies Served by Structured Settlements

A. *Background*

Over the past two years, there has been dramatic growth in a transaction, generally known as a “factoring” transaction, that effectively takes the structure out of structured settlements.

In such a factoring transaction, the injured victim who is receiving periodic payments of damages for physical injuries under a structured settlement sells his or her rights to future periodic payments to a factoring company. In exchange, the injured victim receives from the factoring company a sharply discounted lump sum payment.

This is a transaction that the injured victim enters into with a third party, completely outside of the structured settlement and generally without even the knowledge of the other parties to the structured settlement. The factoring company is not in the structured settlement business, and the structured settlement company is not in the factoring business.

In an effort to avoid the anti-assignment provisions in the structured settlement agreements, the factoring companies typically have the injured victim simply present the structured settlement company with a change of address to a post office box, or change of direct deposit to a bank account, under the control of the factoring company to accomplish the redirection of payments to the factoring company. Thus, the structured settlement company obligated to make the periodic payment damages under the structured settlement is not a party to the factoring transaction and often has no notice of it at all.

At the time the structured settlement is created, the victim has multiple layers of protection by means of State insurance licensing and regulatory requirements and oversight, the Federal tax law requirements for the terms of a structured settlement, legal counsel, and in many cases court oversight. By contrast, the factoring companies and their transactions are completely unregulated.

B. *Rapid Growth in Factoring Company Purchases of Structured Settlement Payments*

Factoring companies use extensive advertising and telemarketing, as well as direct appeals to plaintiffs’ lawyers coupled with a finder’s fee, to solicit new business. For example, one major factoring company, J.G. Wentworth, stated in a 1997 Securities and Exchange Commission filing that during the first 9 months of 1997 alone, it ran 56,000 television commercials. Wentworth’s SEC filing states that it runs a telemarketing call center with 200 telemarketing stations operating 24 hours a day, 6 days a week.

The factoring companies direct considerable advertising at the plaintiffs' bar, promising the injured victim's lawyer a second fee on the same case—this time by unwinding the structured settlement. For example, an ad by Stone Street Capital, a factoring company, placed in a prominent trial lawyer publication, states:

> "You helped your clients once by winning them a structured settlement. Now you can help them again by showing them how to convert all or a portion of their settlement to a lump-sum payment.
>
> "For each of your clients who exercise this exciting new option, your firm will be compensated for legal fees by facilitating the standardized processing of an annuity purchase agreement. *On average, these fees amount to about $2,000 per conversion*. [Emphasis in original]."

The factoring company business is a rapidly growing one. J.G. Wentworth recently announced that it has undertaken approximately 7,700 structured settlement purchase transactions with a total value of $370 million. According to SEC filings, during the first 9 months of 1997, J.G. Wentworth undertook 3,759 structured settlement purchase transactions. These purchased structured settlement payments had a total undiscounted maturity value of $163.6 million and were purchased for $74.4 million. Blocks of purchased structured settlement payments are now being "securitized" by the factoring companies and marketed on Wall Street.

C. *Public Policy Concerns Created by Factoring Company Transactions*

Factoring company purchases of structured settlement payments create serious problems affecting all participants in structured settlements and directly thwart the clear Congressional policy that underlies the structured settlement tax rules.

- Factoring company purchases of structured settlement payments trigger the very same dissipation risks that *structured settlements are designed to avoid*

As Sen. Baucus observed "All of the careful planning and long-term financial security for the injured victim and his or her family can be unraveled in an instant by a factoring company offering quick cash at a steep discount." (Congressional Record (daily ed.) 10/5/98, at S 11500).

As lump sum tort recoveries frequently dissipate, the lump sum from the factoring company is as quickly dissipated, and the injured person finds himself or herself in the very predicament the structured settlement was intended to avoid.

Having factored away their only assured source of future financial support and then dissipating the cash received, these injured victims are likely to face an uncertain financial future and may face the prospect of taxpayer-financed assistance programs to cover their future medical expenses and basic living needs.

As Rep. Clay Shaw (R–Fla.) stated in introducing the "Structured Settlement Protection Act" (H.R. 263) along with Rep. Pete Stark (D–Ca.) and a broad bipartisan group totaling some 17 Members of the Ways and Means Committee: "As long-time supporters of structured settlements and the congressional policy underlying such settlements, we have grave concerns that these factoring transactions directly undermine the policy of the structured settlement tax rules." (Congressional Record (daily ed.) 2/10/99, at E192).

On the Senate side, as Sen. Baucus observed in introducing the same legislation:

> "I speak today as the original Senate sponsor of the structured settlement tax rules that Congress enacted in 1982. I rise because of my very grave concern that the recent emergence of structured settlement factoring transactions—in which factoring companies buy up the structured settlement payments from injured victims in return for a deeply-discounted lump sum—completely undermines what Congress intended when we enacted these structured settlement tax rules."

[*Congressional Record,* (daily ed.), 10/5/98, at S11499.]

Sen. Baucus then went on to say:

> "As a long-time supporter of structured settlements and an architect of the Congressional policy embodied in the structured settlement tax rules, I cannot stand by as this structured settlement factoring problem continues to mushroom across the country, leaving injured victims without financial means for the future and forcing the injured victims onto the social safety net—precisely the result we were seeking to avoid when we enacted the structured settlement tax rules."

[*Id.,* at S11500.]

Sen. Chafee, lead Republican co-sponsor of the legislation, echoed Sen. Baucus's concerns: "These factoring company purchases directly contravene the intent and policy of Congress in enacting the special structured settlement tax rules." (*Congressional Record* (daily ed.) 10/2/98, at S11340.)

NSSTA's members are on the front lines. We see the human costs when factoring companies unravel the structured settlements to injured victims. Court records from across the country tell the story—there's the quadriplegic in Oklahoma, the quadriplegic in California, the paraplegic in Texas, the victim of Connecticut with traumatic brain injures dating from childhood, and the injured worker receiving worker's compensation benefits in Mississippi—all selling their future payments to the factoring companies. The human costs in factoring cases such as these were recently chronicled in a *U.S. News & World Report* entitled "Settling for Less—Should accident victims sell their monthly payments?" (January 25, 1999), pp. 62–66.

• Factoring company purchases often are made at sharp discounts

In many cases the injured victim's dissipation risks are magnified because the lump sum payment that the injured victim receives in the factoring transaction is so sharply discounted. While factoring transactions apparently reflect a range of discounts, it is not uncommon for an injured victim to receive a lump sum payment of half or even less of the present value of the structured settlement payments being sold.

In one recent case, a 20-year-old structured settlement recipient who was receiving monthly payments from a tort action when she was a child was persuaded to sell a series of her future payments for approximately 36 percent of their discounted present value. A few months later, she was persuaded to sell additional future payments for approximately 15 percent of their discounted present value.

Based on this case and many similar examples from court records, it is clear that in factoring company transactions structured settlement recipients often are persuaded to sell future payments for far less than the payments are worth.

• Factoring company transactions create serious Federal income tax uncertainties for the original parties to the structured settlement

The structured settlement tax rules require that the periodic payments constitute tax-free damages on account of personal physical injuries in the hands of the recipient of those payments. (I.R.C. §§ 130(c)(2)(D); 104(a)(2)). Following the factoring away by the injured victim, the periodic payments are received by the factoring company and its investors and do not constitute tax-free damages in their hands. One of the requirements for a qualified assignment no longer is met. This creates serious Federal income tax uncertainties under the structured settlement tax rules for both the victim and the company funding the structured settlement.

Injured victim:

• The injured victim not only loses the benefit of the future tax-free damage payments, but also runs a risk of being taxed on the lump sum received from the factoring company if such payment is treated as received on account of the sale of the victim's future payment rights and not on account of the original injury.

• If the structured settlement payments were freely assignable by the injured victim and a ready market of financial institutions was available to acquire such payments, the victim might be deemed in constructive receipt of the present value of the future payments just as if the payments could be accelerated. In that case, from the outset of the settlement a portion of each periodic payment would be treated as taxable earnings, rather than tax-free damages.

Company funding the structured settlement:

Under the structured settlement tax rules, the settling defendant (or its liability insurer) assigns its periodic payment liability to a structured settlement company in exchange for a payment which is excluded from the structured settlement company's income if the structured settlement tax rules under I.R.C. § 130 are satisfied and such payment is reinvested in either an annuity or U.S. Treasury obligations precisely matched in amount and timing to the periodic payment obligation to the injured victim. The structured settlement company's income from the payments under the annuity or Treasuries is matched by an offsetting deduction for the damage payment to the victim.

• Once the factoring company buys the injured victim's payments, those payments no longer constitute tax-free personal physical injury damages under Code section 104 in the hands of the recipient, and hence one of the requirements for a qualified assignment under Code section 130(c)(2)(D) no longer is satisfied. The critical question then becomes whether the Code section 130 requirements for a qualified assignment apply only at the time the structured settlement is established or constitute continuing requirements for the structured settlement. On that question, there is no clear-cut answer, and considerable tax uncertainty results.

• The factoring transaction raises the concern that the structured settlement tax rules no longer may be satisfied and the risk that the structured settlement company may be required to recognize and pay tax on amounts previously excluded from its income or to pay tax on the "inside build-up" under the annuity, for which there is no cash distribution to pay the tax. This is a tax risk that the structured settlement company had sought to avoid through use of the anti-assignment provisions in the structured settlement agreement and is not in a position to absorb.

• The structured settlement company may face an obligation to report the payments made to the factoring company as taxable income even though in many cases the identity of the purchaser or even the existence of the factoring transaction itself is unknown.

• Factoring company transactions create risks of double liability for the structured settlement companies

While factoring transactions normally involve only the injured victim and the factoring company, the underlying structured settlements typically involve multiple parties such as family members, defendants, liability insurers, and state workers' compensation authorities in workers' compensation cases. Because structured settlement agreements prohibit transfers of payments, if the structured settlement company makes the payments—even unwittingly—to the factoring company, the structured settlement company may become subject to later claims that it paid the wrong party and could still be required to make the payments as originally required under the settlement. This has happened in several recent cases.

In many cases this risk of double liability is magnified by state statutes that (i) in more than 20 states give statutory effect to contract provisions prohibiting transfers of annuity benefits, and (ii) in nearly all States directly restrict or prohibit transfers of recoveries in various types of cases (e.g., worker's compensation, wrongful death, medical malpractice).

• The uncertainties created by factoring company transactions may discourage future use of structured settlements

These tax risks and double liability risks raised by the factoring transaction are risks that the structured settlement company specifically sought to avoid through the anti-assignment provisions in the structured settlement agreement and is not in a financial position to absorb, years after the original structured settlement transaction was entered into.

These uncertainties and unforeseen risks could jeopardize the continued ability of structured settlement companies to fund settlements in the future. The structured settlement company's participation is necessary to enable structured settlements to be undertaken in the first instance by satisfying the objectives of both sides to the claim: the injured victim needs the long-term financial protection that the structured settlement company's funding arrangement provides, and the settling defendant wishes to close its books on the liability rather than bearing an ongoing payment obligation decades into the future.

III. A Stringent Penalty Tax on Factoring Company Purchasers, Subject to a Limited Exception for Genuine, Court-Approved Hardship, Protects Structured Settlements, the Injured Recipients, and the Underlying Congressional Policy

A. *Gravity of Problem Requires Strong Action by Congress*

In acting to address the concerns over factoring companies that purchase structured settlement payments from injured victims the Treasury Department noted that: "Congress enacted favorable tax rules intended to encourage the use of structured settlements—and conditioned such tax treatment on the injured person's inability to accelerate, defer, increase or decrease the periodic payments—because recipients of structured settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance." (U.S. Department of the Treasury, *General Explanations of the Administration's Revenue Proposals* (Feb. 1999), p. 192).

Treasury then observed that by enticing injured victims to sell off their future structured settlement payments in exchange for a heavily discounted lump sum that may then be dissipated: *"These 'factoring' transactions directly undermine the Congressional objective to create an incentive for injured persons to receive periodic payments as settlements of personal injury claims*." (*Id.,* at p. 192 [emphasis added].)

The Joint Tax Committee's analysis of the issue last year echoes these concerns: "Transfer of the payment stream under a structured settlement arrangement arguably subverts the purpose of the structured settlement provisions of the Code to promote periodic payments for injured persons." (Joint Committee on Taxation, *Descrip-*

tion of Revenue Provisions Contained in the President's Fiscal Year 2000 Budget Proposal (JCS–1–99), (February 22, 1999), p. 329).

A natural question is why use the tax system to solve this problem? Isn't consumer protection best left to the States? We believe there are compelling reasons for the Ways and Means Committee to act. The problem is nationwide and mushrooming. A State-by-State approach could take years. Moreover, while noting that the States traditionally have been the province of consumer protection, the Joint Committee's analysis reasons that there is a clear role for the Federal tax law to address the policy concerns raised by sales of structured settlement payments: "On the other hand, the tax law already provides an incentive for structured settlement arrangements, and if practices have evolved that are inconsistent with its purpose, addressing them should be viewed as proper." (Joint Committee *Description, supra,* at p. 330).

Indeed, as Rep. Shaw observed in introducing H.R. 263 which addresses the structured settlement problem by means of a penalty tax on the factoring company: "Because the purchase of structured settlement payments by factoring companies directly thwarts the congressional policy underlying the structured settlement tax rules and raises such serious concerns for structured settlements and injured victims, it is appropriate to deal with these concerns in the tax context." (*Congressional Record* (daily ed.) 2/10/99, at E192).

Similarly, as Sen. Chafee observed last year in introducing the same legislation on the Senate side: "It is appropriate to address this problem through the federal tax system because these purchases directly contravene the Congressional policy reflected in the structured settlement tax rules and jeopardize the long-term financial security that Congress intended to provide for the injured victim. The problem is nationwide, and it is growing rapidly." (*Congressional Record* (daily ed.), 10/2/98, at S11340).

House Ways and Means Chairman Archer has indicated informally that, "If there are abuses out there, we'll look for them, we'll ferret them out, and we will do away with them." (*BNA Daily Tax Reporter,* 12/5/99, GG–1), and in later remarks pointed to transactions that make "an end run around the Code." Clearly, factoring company purchases of structured settlement payments from injured victims fall into the category of abusive transactions to which Chairman Archer refers.

A Federal tax approach also is necessary in order to address the tax uncertainties that the factoring transaction creates for the parties to the original structured settlement.

There is broad bipartisan support among Members of the House Ways and Means Committee, the Senate Finance Committee, and from Treasury for addressing the structured settlement factoring problem by means of a stringent penalty on the factoring company to discourage the transaction, except in cases of genuine, court-approved hardship of the injured victim.

B. *Treasury Proposal*

The Treasury Department in the Administration's FY 2000 Budget has proposed a 40-percent excise tax on factoring companies that purchase structured settlement payments from injured victims.

Under the Treasury proposal, "any person purchasing (or otherwise acquiring for consideration) a structured settlement payment stream would be subject to a 40 percent excise tax on the difference between the amount paid by the purchaser to the injured person and the undiscounted value of the purchased income stream, unless such purchase is pursuant to a court order finding that the extraordinary and unanticipated needs of the original recipient render such a transaction desirable." (Treasury General Explanations (Feb. 1999), at p. 192). The proposal would apply to transfers of structured settlement payments made after date of enactment.

The Treasury proposal represents a strong and appropriate response to the structured settlement factoring problem.

C. *Bipartisan Congressional Proposal*

1. *Stringent penalty on factoring company that purchases structured settlement payments from injured victims*

Reps. Clay Shaw (R–Fl.) and Pete Stark (D–Ca.), two senior Members of the Ways and Means Committee, have introduced H.R. 263 (the "Structured Settlement Protection Act") which adopts a similar approach by imposing a 50 percent excise tax on the difference between the amount paid by the purchaser to the injured victim and the undiscounted value of the purchased payment stream. H.R. 263 is co-sponsored by a broad bipartisan group totaling 17 Members of the Ways and Means Committee. It is endorsed by the National Spinal Cord Injury Association and the National Organization on Disability. It is supported by Treasury.

Sens. John Chafee (R–R.I.) and Max Baucus (D–Mt.) introduced companion legislation last year with similar broad bipartisan support among Finance Committee Members.

As Sen. Baucus noted, the excise tax approach is a penalty, not a tax increase or a new tax: "I would stress that this is a penalty, not a tax increase—the factoring company only pays the penalty if it undertakes the transaction that Congress is seeking to discourage because the transaction thwarts a clear Congressional policy." (*Congressional Record* (daily ed.), 10/5/98, at S11500).

2. *Exception for limited cases of genuine, court-approved hardship*

This stringent excise tax would be coupled with a limited exception for genuine, court-approved financial hardship situations. The excise tax would apply to factoring companies in all structured settlement purchase transactions except in the case of a transaction that is pursuant to a court order finding that "the extraordinary, imminent, and unanticipated needs of the structured settlement recipient or his or her dependents render such a transaction appropriate."

This exception is intended to apply only to a limited number of cases in which a genuinely "extraordinary, imminent, and unanticipated" hardship actually has arisen (e.g., serious medical emergency for a family member) and which has been demonstrated to the satisfaction of a court, as well as a showing that transferring away such payments will not leave the injured victim and his or her family exposed to undue financial hardship in the future when the structured settlement payments no longer are available.

3. *Need to protect the tax treatment of the original structured settlement*

In the limited instances of extraordinary and unanticipated hardship determined by court order to warrant relief, adverse tax consequences should not be visited upon the claimant or the other parties to the original structured settlement. Accordingly, the bipartisan Congressional proposal would clarify in the statute or the legislative history that in those limited instances in which the extraordinary, imminent, and unanticipated hardship standard is found to be met by a court, the original tax treatment of the structured settlement under I.R.C. §§ 104, 130, 72, and 461(h) would be left undisturbed.

That is, the periodic payments already received by the claimant prior to any factoring transaction would remain tax-free damages under Code section 104. The assignee's exclusion of income under Code section 130 arising from satisfaction of all of the section 130 qualified assignment rules at the time the structured settlement was entered into years earlier would not be challenged. Similarly, the settling defendant's deduction under Code section 461(h) of the amount paid to the assignee to assume the liability would not be challenged. Finally, the status under Code section 72 of the annuity being used to fund the periodic payments would remain undisturbed.

Despite the anti-assignment provisions included in the structured settlement agreements and the applicability of a stringent excise tax on the factoring company, there may be a limited number of non-hardship factoring transactions that still go forward. If the structured settlement tax rules under I.R.C. §§ 130, 72, and 461(h) had been satisfied at the time of the structured settlement and the applicable structured settlement agreements included an anti-assignment provision, the original tax treatment of the other parties to the settlement—i.e., the settling defendant and the Code section 130 assignee—should not be jeopardized by a third party transaction that occurs years later and likely unbeknownst to these other parties to the original settlement.

Accordingly, the bipartisan Congressional proposal also would clarify in the case of a non-hardship factoring transaction, that if the structured settlement tax rules under I.R.C. §§ 130, 72, and 461(h) had been satisfied at the time of the structured settlement and the applicable structured settlement agreements included an anti-assignment provision, the section 130 exclusion of the assignee, the section 461(h) deduction of the settling defendant, and the Code section 72 status of the annuity being used to fund the periodic payments would remain undisturbed.

Finally, the bipartisan Congressional proposal would clarify the tax reporting obligations of the annuity issuer and section 130 assignee in the event of a factoring transaction. In the case of a factoring transaction, either on a court-approved hardship basis or a non-hardship basis, of which the annuity issuer has actual notice and knowledge, assuming that a tax reporting obligation otherwise would be applicable, the annuity issuer would be obligated to file an information report with the I.R.S. noting the fact of the transfer, the identity of the original payee, and the identity where known of the new recipient of the factored payments. No reporting obligation would exist where the annuity issuer (or section 130 assignee) had no knowledge of the factoring transaction.

CONCLUSION

H.R. 263 fully protects structured settlements, the injured victims, and the Congressional policy underlying structured settlements.

H.R. 263 has broad bipartisan support among Members of the Ways and Means Committee. It is endorsed by the National Spinal Cord Injury Association and the National Organization on Disability. It is supported by Treasury.

This bipartisan Congressional proposal should be included as part of the tax legislation considered by Congress this year.

Chairman HOUGHTON. Thank you very much.

Now, I would like to call on Ms. Kucenski from Illinois.

STATEMENT OF DONNA KUCENSKI, SENECA, ILLINOIS; ON BEHALF OF NATIONAL ASSOCIATION OF SETTLEMENT PURCHASERS

Ms. KUCENSKI. My name is Donna Kucenski. I appear here today to express my concern that the Federal Government and Congress are considering legislation that would eliminate my right to choose how to conduct my financial affairs. This proposed new excise tax would make it prohibitively expensive for me and thousands of individuals like me to receive lump sums in exchange for an asset that may no longer serve the needs for which it was originally established. This proposal will punish rather than protect consumers. Individuals who enter into structured settlements and those who later wish to sell them deserve full and complete disclosure in order to make informed financial decisions.

I am 30 years old, married with a 7-year-old daughter, and live in Seneca, Illinois. When I was 13 years old, I was mauled by a dog that resulted in serious scarring and damage to my thigh. The incident was traumatic for me, but not by comparison to the fight put up with me by the insurance company and the litigation that followed.

Further, that fight pales in comparison to the struggles I have engaged in over the past 2 years to gain access to a portion of my settlement to meet legitimate needs of me and my family that arose years after the agreement was negotiated. Those needs could not have been anticipated at the time the settlement was proposed.

After the incident, when I was 13, my mother and grandfather obtained an attorney, and 3-year litigation ensued. Only after I was at court on that case, a jury was selected, did the insurance company make a serious settlement offer to my attorney.

After decisions, my mother and grandfather, through the help of our attorney, agreed to a structured settlement, which provided \$475 a month beginning at the age 19, a minimum of 30 years guaranteed. In addition, I was entitled to receive four \$10,000 payments beginning at age 19, \$35,000 at age 30, \$60,000 at age 35. I think it is important to know that part of the reason for settling in this manner was sheer exhaustion and exacerbation in the litigation process.

I suffered no disabilities as a result of the incident that gave rise to the settlement other than a disfigured thigh that cannot be repaired with surgery. I am college educated. I had been employed as a successful real estate agent for the past 5 years. In 1990, I was married. My husband is employed as a mechanical engineer.

Several years after our marriage, we decided to have our first child. I am now the mother of a 7-year-old daughter. Planning to expand our family and wanting to improve the living arrangements, my husband and I decided to purchase a home in late 1997.

However, notwithstanding the fact that we both earn good salaries and have for some time, we didn't have sufficient downpayment to purchase the home we really wanted. A large downpayment would make the mortgage payments much more affordable, allowing us to live the life we desire.

We also want to avoid paying private mortgage insurance at no extra cost of first-time home buyers. Furthermore, we want to be able to afford monthly expenses on my husband's salary alone, as we are hoping for our second child.

With these things in mind, we began examining our financial options. In late 1997, I responded to an advertisement from the company that stated it could pay me a lump sum in exchange for some of my settlement payments. After contacting Singer Asset Finance Co., the process was explained to me in detail. The paperwork provided to me was extremely thorough, set forth the exact terms of the transaction in plain English with no hidden terms, charges, or provisions. The company was also very careful in explaining those terms to me.

After consulting my husband and negotiating the purchase price of a portion of my future settlement payments, I agreed to this transaction. Singer began a thorough underwriting process in which they carefully evaluated my ability to support my family and myself. Singer wanted to ensure that the transaction would be in my and my family's best interest.

After filing the requisite documents and complying with their thorough due diligence, Singer informed Prudential Insurance of the assignment by sending them a notarized document signed by me instructing them to make a series of future payments to Singer instead of me. At that point, I received a lump sum I had been promised. We purchased our home.

As a result of that refinancing transaction, we were able to make a substantial downpayment on the home of our choice, thereby reducing our monthly expenses. This also provided for significant equity nest built into the house. The folks at Singer were professional and courteous throughout the process, that was made even longer because of resistance and lack of cooperation from the insurance company, Prudential.

After closing on our home and living in it some time, my husband and I decided to make home improvements. We were also interested in expanding our investment portfolio. Having been satisfied with the first transaction with Singer, we contacted them again for future payments in which I was entitled to. In the summer of 1998, I again contacted Singer. They spelled out the terms of the transaction. Unfortunately, I was advised that due to a change in the law with the State of Illinois, it would be required for me to go to court in order to transfer these payments. This process was costly, time consuming for me and my husband. Both us and Singer retained a counsel and waited 2 months until the hearing could be scheduled. The judge in this matter was not familiar with the law and how to apply it. He took testimony from us, including very invasive personal questions. After hearing this testimony, the judge granted the order, permitting me to sell a future portion of my payments. I was embarrassed at having to answer very detailed, personal questions regarding my life and finances in open court.

Now I understand that virtually every insurance carrier contests court proceedings such as mine, which increases the cost many thousands of dollars, and stretches out the process to 6 months or more. Had they done this to me and my husband, I would not have been able to afford the risk of such a potential litigation.

After the court order was finally obtained, Singer paid me the money they had agreed to under the terms of the contract. Again, everything was spelled out in writing and fully disclosed to me ahead of time. No hidden charges, no hidden agendas. With the money we received from the second transaction, my husband and I were able to do home improvements, such as finishing a basement, adding a deck, and adding a driveway. We also took $15,000 remaining and invested it with a Templeton growth fund.

Mr. Chairman, I am here to challenge in the strongest terms possible, the notion that Congress should and can dictate to me and anyone else what we do with our assets. My husband and I are educated and astute individuals. We decided to sell a portion of our payments in order to accomplish the things in life we wanted. Simply stated, there is no reason in the world that people shouldn't be able to refinance their settlements if they choose to do so.

Before I conclude, I would like to share another experience with you and the Committee. In 1998 I was scheduled to appear before the Illinois Legislature to testify against the proposed law that could make it virtually impossible for people like me to access our money. Before the hearing, I heard stories of other individuals who chose to sell their structured settlement payments. They included Mrs. Halit. She was involved in a serious accident resulting in a broken femur——

Chairman HOUGHTON. Is it possible, since the red light is on, to submit those stories of Mrs. Halit, Mrs. Bochette, and Mr. and Mrs. Davenport for the record?

Ms. KUCENSKI. Surely.

Chairman HOUGHTON. Would that be all right?

Ms. KUCENSKI. That's fine.

Chairman HOUGHTON. Maybe you would want to conclude your comments.

Ms. KUCENSKI. OK. Mr. Chairman, my story and those like mine are just some of the thousands of individuals who have been helped by structured settlement purchasing companies. The settlement purchasers I have dealt with have been forthright, honest, and open about the transactions. The right to do with one's money as one chooses should not be quickly or arbitrarily stripped from Americans such as myself. Furthermore, conditioning the right to use one's money on obtaining a court order that is cumbersome, expensive, and very time consuming is not, in my opinion, sensible. The right to economic self-determination is fundamental to all Americans. I urge you to consider this seriously before you act. I appreciate the opportunity to present my views to the Committee, and trust that they will be incorporated in the Committee's decision respecting this matter.

[The prepared statement follows:]

Statement of Donna Kucenski, Seneca, Illinois; on Behalf of National Association of Settlement Purchasers

My name is Donna Kucenski. I appear here today to express my concern that the Federal government and this Congress are considering legislation that would eliminate my right to choose how to conduct my financial affairs. This proposed new excise tax would make it prohibitively expensive for me and thousands of individuals like me to receive lump sums in exchange for an asset that may no longer serve the needs for which it was originally established. This proposal will punish rather than protect consumers like myself. Individuals who enter into structured settlements and those who later wish to sell them deserve full and complete disclosure in order to make informed financial decisions.

I am 30 years old, married with a 7-year-old daughter and live at P.O. Box 761, Seneca, Illinois. When I was 13 years old, I was mauled by a dog that resulted in serious scarring and damage to my thigh. The incident was traumatic for me but not by comparison to the fight put up be the insurance company in the litigation that followed. Further, that fight pales in comparison to the struggles I have engaged in over the last two years to gain access to a portion of my settlement to meet legitimate needs of me and my family that arose years after the settlement agreement was negotiated. Those needs could not have been anticipated at the time the settlement was first proposed.

After the incident when I was 13, my mother and grandfather retained an attorney and a 3-year litigation ensued. When I was 16, I was in court on that case. After a jury had been selected, the insurance company finally decided to make a serious settlement offer to my attorney. After settlement discussions, my mother and grandfather with the help of our attorney, agreed to a structured settlement which provided for payments of $475 a month beginning when I reached the age of 19. Those payments were for life with 30 years guaranteed. In addition, I was entitled to receive four $10,000 annual payments beginning when I was 19, a $35,000 payment when I reached the age of 30 and a $60,000 payment when I reached the age of 35. I think it is important to know that part of the reason for settling in this manner was shear exhaustion and exasperation at the litigation process.

I suffered no disability as a result of the incident that gave rise to this settlement other than a disfigured thigh that cannot be repaired with surgery.

I am college educated and have been employed as a successful real estate sales agent for the past 5 years. In 1990, I was married. My husband is employed as a mechanical engineer. Several years after our marriage, we decided to have our first child. I am now the mother of a 7-year-old daughter. Planning to expand our family and wanting to improve our living arrangements, my husband and I decided to purchase a home in late 1997. However, notwithstanding the fact that we both earn good salaries and have for some time, we didn't have a sufficient down payment to purchase the home we really wanted. We had decided that a large down payment would make the mortgage payments much more affordable for us and would allow us to live the life we desire. We also wanted to avoid paying private mortgage insurance and the extra costs usually incurred by first time homebuyers. Furthermore, we wanted to be able to afford our monthly expenses on my husband's salary alone as we are hoping to have a second child.

With these things in mind, we began examining our financial options. In late 1997, I responded to an advertisement from a company that stated it could pay me a lump sum in exchange for some of my settlement payments. After contacting this company, Singer Asset Finance Company, the process was explained to me in detail. The paperwork provided to me was extremely thorough and set forth the exact terms of the transaction in plain English with no hidden terms, charges, or provisions. The company was also very careful to explain those terms to me.

After consulting with my husband and negotiating a purchase price for a portion of my future settlement payments, I agreed to the transaction with Singer Asset Finance. Singer then began a thorough underwriting process in which they carefully evaluated my ability to support my family and myself. Singer wanted to assure that the transaction would be in my and my family's best interest. After filing all the requisite documents and completing their thorough due diligence, Singer informed Prudential Insurance of the assignment by sending them a notarized document signed by me instructing them to make a series of future payments to Singer instead of me. At that point, I received the lump sum I had been promised and my husband and I proceeded to purchase our home. As a result of that refinancing transaction, we were able to make a substantial down payment on the home of our choice, and thereby reduce our monthly expenses. This also provided for a significant equity nest egg built into the house. The folks at Singer were professional and courteous throughout the process that was made even longer because of resistance and lack of cooperation from the insurance company, Prudential.

After closing on our home and living in it for some time, my husband and I decided to do some home improvements. We were also interested in expanding our investment portfolio. Having been satisfied with the first transaction with Singer Asset Finance, we contacted them again in order to sell some more of the future payments to which I am entitled. In the summer of 1998, I again contacted Singer.

Once again, Singer spelled out all of the terms of the transaction in clear, easy to understand terms. Unfortunately, I was advised that due to a change in the law in the state of Illinois, I would be required to go to court in order to transfer these payments. This process was costly and time consuming for my husband and me. Both we and Singer retained counsel and waited over two months until a hearing could be scheduled. The judge in that matter was not familiar with the Illinois Law or with how to apply it. He took testimony from my husband and me, including very invasive personal questions. After hearing this testimony, the judge granted the Order permitting me to sell a future portion of my payments. I was embarrassed at having to answer very detailed, personal questions regarding my life and my finances in open court. Now, I understand that virtually every insurance carrier contests court proceedings such as mine, which increases the costs many thousands of dollars and stretches out the process to six months or more. Had they done this to me and my husband I wouldn't have been able to afford the risk of such a protracted litigation.

Sometime after the hearing, an Order was finally obtained from the Court and Singer paid me the money they had agreed to under the terms of the contract. Again, everything was spelled out in writing and fully disclosed to me ahead of time. No hidden charges. No hidden agendas. With the money we received from that second transaction, my husband and I were able to make some home improvements and invest a substantial sum of money in the market. After finishing the basement, adding a deck to our home and repaving the driveway, we had more than $15,000 remaining with which to invest. This money is now invested in a Templeton Growth Fund.

Mr. Chairman, I am here to challenge, in the strongest terms possible, the notion that Congress can and should dictate to me or anyone else what we can do with an asset. My husband and I are educated and astute individuals. We decided to sell a portion of our payments in order to accomplish the things in life that we wanted. Simply stated, there is no reason in the world that people shouldn't be able to refinance their settlements if they choose to do so.

Before I conclude, I would like to share another experience with you and the committee. In 1998, I was scheduled to appear before the Illinois Legislature to testify against a proposed law that could have made it virtually impossible for people like me to access our money. Before that hearing I heard the stories of other individuals like myself who had chosen to sell some of their structured settlement payments. They include:

Irene Halit: Ms. Irene Halit was involved in a severe accident resulting in a broken femur and the amputation of her left leg below the knee. Ms. Halit had the option of receiving a lump sum settlement or a structured settlement. After consulting with her family and her attorney she decided to accept the structured settlement which provided for lump sum payments as follows: $10,000 due January 1, 1989; $20,000 due January 1, 1994; $30,000 due January 1, 1999; $50,000 due January 1, 2004; and $100,000 due January 1, 2009. Ms. Halit was 18 years old at the time of the settlement. 15 years later, Ms. Halit's needs changed. She was getting a divorce, wanted to return to school and was in need of a new prosthetic limb. Faced with these needs, in 1997, Ms. Halit sold the payment she was to receive in 1999 for a discounted lump sum. With this money she was able to complete school, satisfy some debts, purchase a new prosthesis and conclude her divorce proceedings.

Mr. and Mrs. Edward Bochette: Mr. Bochette's wife was involved in an accident in 1992. Mr. and Mrs. Bochette did not want a structured settlement. However, the insurance company indicated that if they did not accept the structure it would not settle the lawsuit. Mr. and Mrs. Bochette feel they were coerced into accepting the structured settlement. To quote Mr. Bochette the structured settlement was "rammed down our throats" by the insurance carrier. Mr. Bochette became the recipient of the annuity payments through a divorce settlement. Thereafter, Mr. Bochette decided to sell a portion of his future payments in order to purchase a new car and satisfy some outstanding debts.

Mr. and Mrs. Anthony Davenport: Due to a 1987 accident, Mr. Davenport has a permanent scar across chest, rods in his legs, a scar across his hip, and a scar from his forehead all the way to the back of his head. Mr. Davenport begrudgingly accepted a structured settlement after battling with the insurance company and their lawyers for over five years. Six months prior to the settlement, Mr. Davenport and his wife gave birth to twin boys. This placed a significant and unexpected financial burden on the Davenports prompting them to accept the structured settlement. Their attorney also advised the structured settlement was, in his opinion, a better deal. The settlement was for ten annual payments of $2,295 commencing February 13, 1994 through February 13, 2003. An additional lump sum payment of $40,000 was due February 13, 2005. The insurance company represented the settlement was worth $62,950, whereas the present value of the settlement was a mere $26,000. In 1997, the Davenport's found themselves in a financial bind as a result of temporary unemployment. They sold their remaining settlement payments to satisfy debts and clear up a mortgage default that was threatening their home. The flexibility and freedom provided by the lump sum allowed Mr. Davenport to return to school so he could qualify for a better job in the future.

Mr. Chairman, my story and stories such as those of Irene Halit, the Bochettes, and the Davenports are just some of the thousands of individuals who have been helped by structured settlement purchasing companies. The settlement purchasers I have dealt with have been forthright, honest and open about the transactions. The right to do with one's money as one chooses should not be quickly or arbitrarily stripped from Americans such as myself. Furthermore, conditioning the right to use one's money on obtaining a court order that is cumbersome, expensive and very time consuming is not, in my opinion, sensible. The right to economic self-determination is fundamental to *all* Americans and I urge you to consider this seriously before you act. I appreciate the opportunity to present my views to the committee and trust that they will be incorporated in the committee's decision respecting this matter.

Thank you very much.

Chairman HOUGHTON. Thank you very much.

Now I would like to call on Thomas Countee.

STATEMENT OF THOMAS H. COUNTEE, JR., EXECUTIVE DIRECTOR, NATIONAL SPINAL CORD INJURY ASSOCIATION, SILVER SPRING, MARYLAND

Mr. COUNTEE. Thank you, Mr. Chairman. My name is Thomas H. Countee, Jr., executive director of the National Spinal Cord Injury Association, a national nonprofit organization headquartered in Silver Spring, Maryland. The association's president is Jack Dahlberg, who is a quadriplegic.

On a personal note, I was born, raised, and educated right here in Washington, DC. In 1958, 41 years ago, I sustained a diving accident on the Chesapeake Bay, rendering me a quadriplegic. I am an attorney. I served for 15 months as legislative counsel in the Ford White House. It is a pleasure and honor to return to the Hill today to testify, this time as a private citizen.

Today, I represent over 5,000 members of the National Spinal Cord Injury Association, and thousands of other spinal cord-injured persons, many of whom benefit from structured settlements, including several hundred in the Metropolitan Washington area. The National Spinal Cord Injury Association has no business or tax effect stake in the outcome of this proposed legislation, H.R. 263. However, the association is deeply interested in the health, safety, and welfare of persons with catastrophic, traumatic, and/or debilitating injuries, many of whom are association members and receive structured settlements.

The National Spinal Cord Injury Association is extremely concerned about factoring companies which increasingly prey upon the weakest, most gullible, and most vulnerable in our society. We believe that at present, the emerging gray market of factoring companies is largely unregulated, unresponsive to the needs and best interests of recipients of structured settlements, and unconscionable in their slick, high pressure marketing practices and unethical legal maneuvers and strategems, such as the use of a confessed judgment against the victim in a distant court to garnish the victim's payments.

I have testified on this matter before State legislatures considering similar legislation, Mr. Chairman. I have read Mr. Chapoton's submitted testimony and listened to his testimony this morning. I am struck by its familiarity. Mr. Chapoton asserts that "NASP members do not conduct transactions with individuals dependent on further periodic payments for medical necessity or with those who are unemployed or unemployable who rely on their payments as the sole source of income" and "they do not buy payments from individuals with catastrophic or head injuries."

Mr. Chairman, with all due respect to my fellow member of the bar, these assertions are simply inaccurate, misleading, or false. Just look at the pictures in the U.S. News and World Report article of January 25, 1999. Look at Christopher Hicks, a quadriplegic. Look at Raymond White, who was unemployed when he sold the first portion of his settlement and who now relies partially on public assistance to get by, according to the article. Look at Davinia Willis in her wheelchair.

Until the National Spinal Cord Injury Association realized what kind of business factoring companies were really in, our SCI Life magazine, published quarterly, accepted their advertising. We don't do that any longer. They were targeting our members and not only because many of them had structured settlements.

One last point, Mr. Chairman, I have come here today to let you see the type of catastrophic injury affected by this bill, and to put a human face on this legislation, not as a beneficiary of a structured settlement, but as the leader of, and advocate for, severely disabled persons who have.

In 1982, the intent of Congress, the social purpose, if you will, was to encourage those who receive monetary settlements growing out of catastrophic injuries to accept period payments to safeguard the very uncertain futures that they faced. Factoring companies' intent, on the other hand, is simply to cheat severely injured persons out of their money. H.R. 263 does nothing to help those who have already been taken advantage of. We need this legislation to guide those who may be taken advantage of in the future. You can and should stop this outrage. Sound public policy and simple decency would indicate that as legislators, you have no choice but to do the right thing.

For all the above reasons, the National Spinal Cord Injury Association respectfully recommends and strongly urges your support of H.R. 263, which would provide needed protection from the predatory practices of these factoring companies.

Thank you very much for the time and attention, Mr. Chairman, you are devoting to this critical issue, and the opportunity to appear before you. I would be happy to answer any questions you might have about the association and our interest in this matter.

[The prepared statement follows:]

Statement of Thomas H. Countee, Jr., Executive Director, National Spinal Cord Injury Association, Silver Spring, Maryland

Good afternoon, Mr. Chairman and other Representatives.

My name is Thomas H. Countee, Jr., Executive Director of The National Spinal Cord Injury Association, a non-profit organization, headquartered in Silver Spring, Maryland. The Association's President is Jack Dahlberg, who is a quadriplegic.

On a personal note, I was born, raised and educated right here in Washington, D.C. Forty-one years ago in 1958, I sustained a diving accident on the Chesapeake Bay, rendering me a quadriplegic. I served 15 months as Legislative Counsel in the Ford White House. It is a pleasure and honor to return to The Hill to testify, this time as a private citizen.

Today, I represent over 5,000 members of the National Spinal Cord Injury Association and thousands of other spinal cord injured persons, many of whom benefit from structured settlements, including several hundred in the Metro Washington area. The National Spinal Cord Injury Association has no business or tax effect stake in the outcome of this proposed legislation, H.R. 263. However, the Association *is* deeply interested in the health, safety and welfare of persons with catastrophic, traumatic and/or debilitating injuries, many of whom are Association members and receive structured settlements.

The National Spinal Cord Injury Association is extremely concerned about factoring companies which increasingly prey upon the weakest, most gullible and most vulnerable in our society. We believe that at present, the emerging "gray market" of factoring companies is largely unregulated, unresponsive to the needs and best interests of recipients of structured settlements and unconscionable in their slick, high pressure marketing practices and unethical legal maneuvers and strategems such as the use of a confessed judgment against the victim in a distant court to garnish the victim's payments.

One last point, Mr. Chairman, I have come here to let you see the type of catastrophic injury affected by this bill and to put a human face on this legislation, not as the beneficiary of a structured settlement, but as a leader of, and advocate for, severely disabled persons who have. In 1982, the intent of Congress, the social purpose, if you will, was to encourages those who receive monetary settlements growing out of catastrophic injuries, to accept periodic payments to safeguard the uncertain futures they face. Factoring companies' intent, on the other hand, is simply to cheat severely injured persons out of their money. You can, and should, stop this outrage. Sound public policy and simple decency would indicate that as legislators, you have no choice but to do the right thing.

For all these reasons, The National Spinal Cord Injury Association respectfully recommends and *strongly* urges your support of H.R. 263 which would provide needed protection from the predatory practices of these factoring companies.

Thank you for the time and attention you are devoting to this critical issue and the opportunity to appear before you. I will be happy to answer any questions you may have about the Association or our interest in this matter.

Chairman HOUGHTON. Thank you, Mr. Countee. Thank you, everybody, for your testimony.

What I would like to do is forgo my questions and turn it right over to Mr. Coyne. Then, we will go right down to the end and come back here with a question.

Go ahead, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Chapoton, you seem to be testifying more in opposition to the proposed legislation based on the fact that it is a consumer protection issue rather than a taxation issue.

Mr. CHAPOTON. That is correct, sir.

Mr. COYNE. But I would guess that you could imagine that there would be instances where people would have to succumb to some kind of situation where they needed money immediately?

Mr. CHAPOTON. I certainly could imagine that. As I said in my written statement and in my oral presentation today, there should be protection. The result we should try to achieve is a fully informed, fully advised consumer.

Mr. COYNE. Your major objection is just from a consumer protection standpoint?

Mr. CHAPOTON. My major objection is that there are too many fact situations—it is too complicated an issue to deal with in one fell swoop in the tax law. It's really not a tax issue.

Mr. COYNE. Thank you.

Mr. CHAPOTON. Yes, sir.

Mr. COYNE. Ms. Kucenski, you indicated that you and your husband are "educated and astute" and you were able to come to a conclusion that that was the best financial arrangement for you. I guess you could understand where some people who are not as educated or astute in financial matters and may need the protection of something like that?

Ms. KUCENSKI. Yes, I can understand. But there are more factors involved in that too, that may not have the financing or good job or whatever. The age is a factor, well-being, mental stability, things like that.

Mr. COYNE. Thank you.

Chairman HOUGHTON. OK.

Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. It is always nice to have a constituent on the panel today. Donna Kucenski is from Seneca, Illinois.

It's nice the day after St. Patty's Day that someone from the home of the Seneca Irish is with us. I want to welcome you to the Ways and Means Committee. Donna, I appreciate your testimony. Mr. Countee made some pretty strong statements regarding this issue and the intent of those who purchase structured settlements.

You have indicated in your testimony that you felt you were never pressured, you had all the information before you. You have given examples of others that you know personally who have used this as a way to have a little extra money to buy a car or make a downpayment on a home, go back to school. You feel that it's an option people should have as a choice for their finances.

I was wondering, was there anything unexpected after you reached this agreement with the company that purchased your structured settlement? Were there any surprises?

Ms. KUCENSKI. There were no surprises from Singer Assets in general. The surprise the second time was knowing that I had to go before court. That was a surprise. I was told the first time that you know, if you ever want anything else and you need anything, you know where to make a phone call, and that is what my husband and I decided to do. It surprised us going before a judge.

Mr. WELLER. And was there ever a time during your business transaction with the company where they did not honor their side of the bargain?

Ms. KUCENSKI. No. Never a time.

Mr. WELLER. And you have indicated in your testimony that there were two sales, I guess, of two portions of your structured settlement. Do you still have some of your structured settlement that is still yours?

Ms. KUCENSKI. Yes, I do.

Mr. WELLER. That is still outstanding. You have sold two pieces of it?

Ms. KUCENSKI. Right.

Mr. WELLER. As part of this. From your experience and in talking with others, since you indicated in your testimony you know some other individuals that have done this, you know, Mr. Countee indicated that some people may be exploited by some bad apples maybe in the industry. What type of protections do you feel there is a need for? Clearly you oppose Mr. Shaw's legislation, from your testimony and from our personal conversation you have shared that with me. Do you feel there is a need, if this type of practice continues, for any additional protection to protect those who may be more vulnerable because of their mental condition or physical condition?

Ms. KUCENSKI. I think as an individual who has the settlements and who has the opportunity to move forth with Singer Assets and everything, the documentation that they give you is pretty self-explanatory. If for any reason that me, as the settlement holder, feels that I have been taken for a ride or whatever, we have an attorney that you can hire. There are counsels. I have my own broker that does all my financial arrangements. I consult him. There are many other people that we can hire as a person if we feel that we are being "taken for a ride." That is up to the individual's decision.

Mr. WELLER. OK. Mr. Countee, just in response to Donna Kucenski's statement there, if this practice were to continue, you know, not considering Mr. Shaw's legislation, but if this practice were to continue where people would have the opportunity to purchase settlements and also have the opportunity to sell them, would you see perhaps some particular additional protections that should be put into the law to protect those that you noted may be vulnerable in your testimony?

Mr. COUNTEE. You mean without the provisions of H.R. 263?

Mr. WELLER. That's correct. Are there any other—if the Shaw legislation is not adopted, are there protections that you would suggest that we consider, that the Congress consider as an alternative? Have you thought about any other protections for those who may be vulnerable?

Mr. COUNTEE. Probably some that would fall under the rubric of consumer protection laws. I think that the conduct of the factoring companies that I have outlined, such as confessed judgment against a victim in a distant court, for instance, should be looked at. I think the marketing practices should be looked at.

I think that the provisions of State legislatures, such as bringing any factoring companies' award before the approval of State court should certainly be a provision that is required. I see nothing wrong with bringing these factoring companies' contracts before the light of day, and require court approval of them before they go into effect. I think that this has the advantage at the very least of having them reviewed by someone with the knowledge and background of what the recipient is getting into.

Those are some provisions that I think, and there probably are others that would protect the recipient.

Mr. WELLER. Thank you, Mr. Countee. Donna, I am glad to have you here. Thank you, Mr. Chairman. I see my time is expired.

Chairman HOUGHTON. Thanks, Mr. Weller.

The gentleman from Colorado, Mr. McInnis.

Mr. MCINNIS. Thank you, Mr. Chairman. I appreciate the testimony from the witnesses today. I guess I take a different approach on this. I don't see this as a consumer issue. It appears to me that at some point in all segments of society, that consumers have to accept a little responsibility. I think having heard Ms. Kucenski's testimony, she is certainly capable of handling her own matters.

What I do see, however, and I disagree with the one witness who did not see it as a tax issue, I see it right and center to be a tax issue. The reason is that the present law, because of the injuries that were sustained, according to the legislative history of this, they provided a special exception. They provided a tax subsidy for these type of payments. But to prevent the abuse of this tax subsidy, they put in certain requirements. One of those being that the payments could not be accelerated. It appears to me from my reading, that clearly there is an acceleration here. Clearly there is a change in tax status, and a noninjured party is now obtaining the benefit of the tax subsidy which was never intended for the noninjured party.

I see this as clearly a tax issue. That is how I intend to approach it.

But out of curiosity, I would ask Donna, so I don't keep butchering your last name, if you don't mind me just saying Donna, what was the discount rate that you ended up paying? Do you mind responding to me for that, for the first and second settlement?

Ms. KUCENSKI. Yes. I don't have that information with me. I don't even want to speculate. I don't have that information.

Mr. MCINNIS. Is it Mr. Chapoton, the gentleman there?

Mr. CHAPOTON. No. I could not respond to that. Mr. Trankina could speak on the discount issue if you wish.

Mr. MCINNIS. Now that I have got you on the microphone, you said—no, maybe I didn't hear you correctly. But you said you didn't see this as a tax issue?

Mr. CHAPOTON. No. You heard me correctly.

Mr. MCINNIS. Would you agree——

Mr. CHAPOTON. Let me——

Mr. MCINNIS. No. Let me finish.

Mr. CHAPOTON. If I might go through it very briefly.

Mr. MCINNIS. I reclaim my time. Let me ask you very briefly. Would you agree, yes or no, would you agree that this is a tax subsidy, that it is an exception in the Tax Code, that it is treated as a tax subsidy?

Mr. CHAPOTON. That is an interesting question. It was the IRS ruling policy before the law was enacted. It was the IRS ruling policy before 1982. You got the same result before 1982 as you got after 1982.

Mr. MCINNIS. But it's still a tax subsidy.

Mr. CHAPOTON. It is a tax benefit, yes. I agree with that. It is a tax benefit. The interest element of the structured settlement is not taxed.

Mr. MCINNIS. And under these structured settlements, the tax benefit goes from the original intended party, which would be in most cases the injured party, now I understand you can have lottery winners and people like that, but the witnesses we have heard today are injured parties. It was intended that benefit went to the injured party. Wouldn't you agree now that the benefit through a discount rate, and it affects the discount rate, that benefit now transfers to the recipient receiving those structured checks under an assignment every month?

Mr. CHAPOTON. Well, I think that question comes up, is exactly the same when the structured settlement is entered into, how you split that tax benefit between the structured settlement company and the claimant as it is on the purchase of a structured settlement company some years later. In other words, the two parties you are negotiating are going to split that tax benefit.

Mr. MCINNIS. That's right. I mean it impacts the price.

Mr. CHAPOTON. Correct.

Mr. MCINNIS. I understand the impact on the price, but we have a third party involved here who is not involved in the negotiation. The government, who initiated a tax benefit for the injured party. Now, the second party, the purchaser of the payments come in. They are now the recipient of a tax benefit that was never intended to go to that party. Wouldn't you agree with that?

Mr. CHAPOTON. No. I wouldn't. They are in no different position as far as negotiating for a piece of the whole arrangement than the structured settlement company is. The tax benefit is going to be split between all the parties that negotiate. I agree with that. But I don't know that I see your point that they are different than the structured settlement company.

Mr. MCINNIS. Now correct me if I am wrong, but you said you are a tax attorney?

Mr. CHAPOTON. I am.

Mr. MCINNIS. How would you define then the intent as well as the literal definition of the terms under the qualified assignment cannot be accelerated. How would you define "accelerated"?

Mr. CHAPOTON. The term "accelerated" was also used in the rulings issued by the IRS. It was dealing with the constructive receipt doctrine that the claimant could not accelerate. That does not mean that a claimant cannot enter into a separate, independent, later transaction based on different facts and sell that interest. Acceleration is different than assignment.

Mr. MCINNIS. Even though the payments are accelerated to her, it's just another form? There is still an acceleration of payments to her, but it is through another form. But you don't think that fits under the definition of acceleration?

Mr. CHAPOTON. No, it is not. I definitely do not think it is. The payments are not accelerated. They continue as originally——

Mr. MCINNIS. Well, in form, they continue to another mailbox, but there is a transfer payment to the recipient that accelerates the payments to the recipient.

Mr. CHAPOTON. The recipient gets the funds earlier than they would get them after the sale. Let me go back, if I might——

Mr. MCINNIS. I am out of time. I appreciate it. I would call it acceleration.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much.

The gentleman from Georgia, Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. CHAPOTON. Mr. Chairman, could I respond to one question?

Chairman HOUGHTON. Surely, you bet. Go right ahead.

Mr. CHAPOTON. There was a suggestion that I misanswered Mr. McInnis' question. I assume that you understood, Mr. McInnis, that the payments received by the purchaser are fully taxable. You understood? You were not disagreeing with that, were you? Did I mislead you on that? A purchaser of a settlement is fully taxable on profit it makes on that settlement.

Mr. MCINNIS. On the profit. But the payments that come in on the profit, yes. But on the payments that come in, still are in a tax-exempt status.

Mr. CHAPOTON. No. They are not tax-exempt to the purchaser, no. There is a tax benefit involved in the original claimant's position, but the purchaser is fully taxable on whatever it makes in the transaction.

Mr. MCINNIS. That helps. Thank you.

Mr. CHAPOTON. I'm sorry if I confused you.

Chairman HOUGHTON. OK.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. I wanted to welcome Tim Trankina from the Peachtree Settlement Funding Co. of Norcross, Georgia. He is a good Georgian here today before this fine Subcommittee.

My question is to Mr. Chapoton. What sort of information is provided to a claimant at the time the structured settlement is offered? Tim may want to answer this, I don't know.

Mr. TRANKINA. If I may, Mr. Collins, respond. We typically receive inquiries from individuals at which point we discuss with them their particular financial needs. We attempt to determine the amount of money they are seeking to raise for purposes of improving a home, and so forth. We then go over the program with the individual and the requirements for the program. Then we provide them information on the amount of money we could pay them in exchange for a specific number of payments.

We disclose a lot of information to our clients that is consistent with the disclosure information that has been suggested here. We are very much in favor of consumer protection, and support adding any kind of consumer protection or disclosures that might help people make informed decisions.

Mr. COLLINS. It has been referred to in catastrophic cases that maybe there should be some provision that would prevent these type of purchases of catastrophic cases. But under the ADA, Americans With Disabilities Act, that would not be permitted, would it not?

Mr. TRANKINA. Well, we are in a difficult situation in that circumstance. Eighty-five percent of the structured settlement claimants that we deal with in our business and on a national basis are not disabled and are gainfully employed, and did not sustain a catastrophic injury.

However, our application process asks very specific and detailed questions to determine whether in fact they do have such a disability. Our policy is to reduce from their available payments amounts that are earmarked for specific medical needs and to take into account whether they have a disability.

The ABA dilemma is that if an individual wants to proceed, and they have a disability, our underwriting requirements and commitments to our financial institution partners prohibit us from purchasing more than about 50 percent of such persons payments, even if they were not earmarked for specific medical needs, merely because of the concern for the long-term disability. That is, we don't want to purchase settlement payments that the individual may need on a going-forward basis.

Mr. COLLINS. But you fully disclose all aspects of the agreement of proposed structure purchase before you purchase it?

Mr. TRANKINA. Correct. I am not the general counsel of the company, but we follow, I believe, reg Z or similar Federal lending provision disclosures that would indicate the amount of money that is being given, the number of payments over time that are going to be given or transferred to us, and the interest rate associated with the transfer.

We also provide as an industry, a 3-day right of recision, not merely after the date the contract is signed, which is fairly common in States, but after we have actually closed the transaction so that an individual could return the check to us after closing for up to 3 days thereafter.

Mr. COLLINS. Mr. Little, it looks like the full intent of your support for this legislation is actually to end these purchases of structured settlements.

Mr. LITTLE. I'm sorry, Mr. Collins. Could you repeat the question?

Mr. COLLINS. I said it appears that your support of this type of legislation is aimed at totally eliminating these types of purchases, purchases of structured settlements?

Mr. LITTLE. With the exception, sir, of a hardship case, I would say yes.

Mr. COLLINS. And that is based on what?

Mr. LITTLE. That is based on the flagrant, I would say, attempt to thwart a congressional intent.

Mr. COLLINS. What is the congressional intent?

Mr. LITTLE. The congressional intent, sir, I would say was best stated by Congressman Ramstad 4 years ago when I had breakfast with him. He said that he understood the amendments in 1982 to allow for the structured settlements to permit a profoundly injured person to live her life with dignity free of government.

Mr. COLLINS. But you are wanting government to step in and prevent the opportunity from an individual having access to this type of settlement.

Mr. LITTLE. No, sir. I am wanting the intent of Congress, as embodied in section 104(a)(2) of the Code, and section 130 of the Code to be upheld.

Mr. COLLINS. And that is to prevent the dissipation risks to the individual who was injured who is under the structured settlement?

Mr. LITTLE. Yes, sir.

Mr. COLLINS. Let me ask you this. You also say that a lump sum does the same thing. Would you be in favor of putting the 40 percent on a lump-sum settlement too?

Mr. LITTLE. No, sir, I would not, because I think there's 200 years of common law there.

Mr. COLLINS. But you also go onto say that that also leads to the dissipation of funds.

Mr. LITTLE. I think that what we have to understand is that a personal injury victim has a choice at the time of settlement, a fully informed choice, often times at the advice of counsel, generally at the advice of counsel, and many times requiring court approval.

Mr. COLLINS. But the 40 percent would not totally stop the possible purchase of these type of settlements?

Mr. LITTLE. No, sir. I think again, that our bill has the hardship clause. On the showing of genuine hardship, I think that the purchase could go forward.

Mr. COLLINS. That would be your determination of hardship?

Mr. LITTLE. No, sir. That would be a court's determination of hardship.

Mr. COLLINS. But then it also could lead to someone who is not total hardship, but also wanted to sell their structured settlement to be penalized?

Mr. LITTLE. I don't know if I would agree with you, sir, when you say would be penalized.

Mr. COLLINS. You could pay the 40-percent penalty and still have the purchase of your settlement?

Mr. LITTLE. That is correct. Yes, sir.

Mr. COLLINS. You could actually be penalizing someone as well as trying to stop, because if they were to decide to go ahead, they would just be penalized 40 percent?

Mr. LITTLE. I think that the intent——

Mr. COLLINS. And there probably would be cases where there were people who would do that.

Mr. LITTLE. I suppose it would be foreseeable.

Mr. COLLINS. This is very, I think, unneeded legislation.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks, Mr. Collins.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. This is constituent day. The fine gentleman that my friend from Georgia was just grilling is a constituent of mine. I'll leave the Peachtree guys alone.

Mr. COLLINS. I should have known that by your statement. [Laughter.]

Mr. COLLINS. You are welcome to grill, if you want to, my good friend from Georgia.

Mr. PORTMAN. Thank you, Mr. Chairman, for having this hearing. It is a very important topic.

Mr. Little, I appreciate your coming into town and providing my office, and I think this Subcommittee, with a lot of good information, from your association's position, and also based on your personal experience in being involved in a number of these structured settlements.

One that I remember distinctly was in northern Kentucky, the Carollton bus tragedy. I have not talked to you about this personally, but I know that you were involved in creating some structured settlements for the kids who were injured. There were some severe injuries resulting from that. What has happened with that particular case? You did structured settlements. Have the factoring companies become involved in that, and gone to those families? Do you have any experience there to tell us about?

Mr. LITTLE. That particular case, sir, is probably one of the best examples of the law as it currently stands in place. There was everything in that particular catastrophic accident, from wrongful death to emotional trauma. Several kids died in that schoolbus crash. Several kids were profoundly burned. All of those children were the children of enlisted Army personnel based at Fort Knox. It was a church outing and resulted in that fiery crash on the interstate.

All of those cases, with the exception of four, resulted in a partial structured settlement. There was a lot of analysis that went into that to determine the future of medical needs, the future surgeries that those burn victims would have to have. I am very pleased to say that a lot of those structured moneys was dedicated to the college education funds for those children, for the future psychological treatment of those children. Many of those children went on to become college graduates, the first in the history of their families. Many of those kids, the scarring notwithstanding and the future surgeries that they had, were able to reintegrate into society having had the benefit of the structure to pay for the future surgeries, and go on very well with their lives.

Unfortunately, factually those children were from one community. It was very easy to get the court records by the factoring companies. They have in fact become targets for the factoring companies. They are located in one geographic area, very easy to contact them, very easy to try to persuade them to sell their settlements.

I am happy to tell you that the Kentucky judiciary is not looking favorably on that, because there was a lot of analysis and a lot of thought that went into the settlement of those claims.

Mr. PORTMAN. Was this a court-ordered settlement? Was the judiciary involved?

Mr. LITTLE. It was a court-ordered settlement as to the children who survived. You know, they were minors at that time. The children who died, their parents brought the cause of action, and that did not——

Mr. PORTMAN. The judicial system was involved in the structured settlements as compared to a lump sum at the time?

Mr. LITTLE. Yes, sir. Absolutely.

Mr. PORTMAN. At the time of the accident?

Mr. LITTLE. Yes, sir.

Mr. PORTMAN. With the families of the children?

Mr. LITTLE. Yes, sir.

Mr. PORTMAN. Have the judges in that case and for that matter around the country, to the extent that you know about it, sealed the records of the settlements? You said that they haven't looked favorably upon the factoring companies. How are judges reacting around the country, to your knowledge?

Mr. LITTLE. We see a lot of judicial activism, particularly in cases involving incompetence concerning minors. By judicial activism, what I mean, sir, is that the judges have commented in open court that they are cautious of the factoring companies' advertisements on TV. In that regard, they are ordering that the settlements be sealed. When there is court approval, it needs to be brought to bear on the settlement.

Mr. PORTMAN. Are they permitted to do that?

Mr. LITTLE. Yes, they are.

Mr. PORTMAN. We have a situation now where at least in some cases, the judges are actively keeping the factoring companies from coming in by either sealing the records or in open court discouraging it, or how?

Mr. LITTLE. Not only saying in open court, sir, that the record will be sealed, the terms of the settlement will be sealed, but admonishing the attorneys on both sides to not reveal, if you will, the terms of the settlement in that regard.

Also, we see situations in Hamilton County. That by the way, is particularly true with the judges in Hamilton County back in Cincinnati. Also, the other thing that we are seeing is that the judges, where there is a cash settlement involving a minor or an incompetent, are telling the attorneys to go back and to take a look at a portion of the settlement dollars that would be paid in lump sum, be paid partially in a structured settlement to protect the child or the incompetent from mercenary friends and relatives.

Mr. PORTMAN. Let me ask about the court approval clause in H.R. 263, the Shaw bill. It says there's an exception if the transfer is undertaken pursuant to an order of a court finding that there is an extraordinary unanticipated or imminent need of the structured settlement recipients, spouse or dependents to receive a lump sum.

Mr. LITTLE. Yes.

Mr. PORTMAN. How would that be likely to affect the structured settlements that are currently in place? In other words, how often do you think that would happen?

Mr. LITTLE. In my experience, in almost 20 years as a structured settlement broker, in working in every jurisdiction in this country, I have had three requests by claimants who said "I have a genuine hardship," who have come back to me as the broker that I met at a settlement conference table, and said "Is there any way that you can help me, because we have an emergency."

I am confronted with a surgery that was not anticipated. You know, we have lost our home in a fire, something like that. In all of those three situations, the insurance company worked very closely to try to find a way to help them.

Mr. PORTMAN. I just asked the Chairman if I could keep going beyond the red light here with his indulgence. I want to thank everyone for coming. Buck Chapoton is one of the premier tax lawyers in this town. I respect his opinion on tax matters. I disagree with him somewhat on this one because I do think, and we got into some of those specifics of it, that based on the revenue ruling and in the 1982 change in the law, that we made a conscious decision to provide a tax subsidy, which is the interest on the structured settlement over time, that otherwise would have been taxable. Having made that decision, that was a public policy determination that there was some public good, and what would be considered to be not only a subsidy, but an economic inefficiency otherwise. The question is, is that working and is it consistent with the public good. I think in this respect, there is a lot of evidence that it's not working well in many cases because of the public policy being thwarted by the factoring companies.

Now the question is whether there should be a 50-percent excise tax, or 40 percent, or whether there is something in between, or another way to get at it. But I do think that there is an appropriate public policy here that Congress set out to try to at least confirm in 1982, based on the revenue ruling that ought to be consistent.

Do you have any comment on that?

Mr. CHAPOTON. I would just say I clearly think the benefit should last as long as the structured settlement stays in place and the claimant cannot have the right to accelerate it. My point is that there is a good policy behind that, and it works.

If situations change, and that recipient decides to sell in an unrelated transaction to a third party, then that benefit stops. It seems to me that is quite appropriate and quite consistent with the 1982 legislation.

Mr. PORTMAN. Again, and I understand what you are saying there in terms of policy, that the question is what was the congressional intent and what was the public policy purpose. If it was indeed to permit people to have this protection, and that protection is taken away by a practice that has since occurred, you know, having set that policy in place, and having made that decision, it is a tax issue. It becomes an issue that is before this Subcommittee. Doesn't this Subcommittee have the right then on a tax basis to come in and adjust?

Mr. CHAPOTON. Certainly, in that sense it is a tax issue. There is a tax provision here. My point is the tax provision did not mean to impose a lock-in effect as everyone is interpreting it. That is as clear as a bell. The tax provision did not mean to impose a lock-in effect on the claimant. It did not mean to impose a tax on the structured settlement company if there is a later sale. It meant simply not to stand in the way of structured settlements. Absent that rule, if you didn't have a rule such as contained in sections 130 or 104(a) or in the rulings before those provisions became law, then the structured settlement would have an adverse tax consequence. The rulings and the 1982 Code amendments said you can do it, but did not condition that as people are interpreting it, they did not condition that benefit to require that you can never can sell it in the future. That is just a separate issue, in my mind.

Mr. PORTMAN. Again, I think the more fundamental question is what was the public policy. You just interpreted it as being that the Congress decided it would not stand in the way of structured settlements, looking back at the legislative history. You were probably involved in this at the time and I wasn't. But I think it was not that Congress wouldn't stand in the way, but rather, that Congress would encourage. I think that is a distinction that is important with a difference with regard to what we do going forward. I don't know what precisely the right approach might be to resolve this, but I think if you look back at the public policy intent, it was not to stand in the way. It was actually to encourage, and to the extent that's being discouraged, it might be an appropriate remedy to amend the tax system.

Also, one other thing, Mr. Chairman, if I might. I apologize for the time. We have a very famous panel with us. Mr. Countee was on TV last night. In case you didn't see him, he was there talking about a new golf course for people with disabilities in the State of Maryland. He was interviewed and he did a very good job, as he did this afternoon in talking about that issue.

Thank you, Mr. Chairman.

Mr. COUNTEE. Thank you very much, Mr. Portman.

Chairman HOUGHTON. Should we all meet on the golf course? [Laughter.]

Well, I just have one question. The association has said that under no circumstance would any company or grouping buy settlements from people who really depend upon that income. Here we have this U.S. News and World Report from January 25. There is an article here, "Settling for Less. Should Accident Victims Sell Their Monthly Payments?" Here are two quadriplegics who are suing because they have been taken advantage of. I mean is this true or not?

Mr. TRANKINA. Mr. Chairman, if I could respond to that. I was disturbed as well when I read that article. I can primarily speak for our experience at Peachtree Settlement Funding, but also on behalf of our trade association.

At Peachtree Settlement Funding, it is our policy to carefully examine and obtain information from claimants as to their physical condition and their intended use of funds. We do that through an application process, which asks these types of questions. Do you depend on your payments for medical necessities? Please describe other information about your medical and physical condition. Based on that information, we apply standards that allow us to purchase payments from individuals that are not earmarked for specific medical needs.

Again, 85 percent of our clients do not have any type of long-term disability and are employed. Clients having a long-term disability reflect only a small percentage of our applicants. But also I would like to say with respect to that article, on my own effort for my company and in trying to uphold the ethics we maintain, I wanted to investigate somewhat into those circumstances reflected in the article. There are somewhere in the area of 15,000 structured settlement transactions that have occurred in the secondary market by finance companies, I believe over the last few years. This article highlighted a few situations where transactions may or may not have been appropriate. It would appear they should not have occurred.

We are in a consumer business. We are constantly striving to improve that business. We have wholeheartedly embraced the idea of consumer protection that would prevent any type of abuse to occur. In those particular instances, I believe two of the individuals had diverted some payments and one of the individuals had improperly completed and did not convey truthfully his medical condition in the application. The individuals referenced in the article were not clients of our company.

I was interviewed for about 45 minutes by the author of that article. However, none of the information that I conveyed of the practices of our business was represented. I think it was a highlight of some situations.

More importantly, I think it highlights the need for consumer protection. Again, we wholeheartedly embrace disclosure and the procedures that would permit an individual to make an informed decision.

[The following was subsequently received:]

March 31, 1999

Mr. A.L. Singleton
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Committee on Ways and Means, Subcommittee on Oversight, Tax Treatment of Structured Settlements, Thursday, March 18, 1999

Dear Mr. Singleton:

I greatly appreciated the opportunity to testify before the Subcommittee on Oversight in the above-reference matter. It was truly a privilege and honor for me as a citizen to participate in the legislative process at the federal level.

As a follow-up to the hearing, I have set-forth below responses to a few items/ questions left open at the hearing and for which I have personal knowledge and/ or requested permission to provide a response subsequent to the hearing.

1) Ms. April Fely—Testimony was offered by the proponents of the excise tax related to Ms. April Fely, a client of Peachtree Settlement Funding. Ms. Fely, who was not present at the hearing nor consulted prior to, was portrayed by the proponents of the excise tax as having lost her dignity by squandering her structured settlement. This portrayal is not only inaccurate, but offensive to Ms. Fely, as well as others in her situation who often must make difficult decisions in order to move themselves and their families forward. Quite to the contrary, Ms. Fely made an informed and educated decision to sell her future settlement payments to meet her changing financial circumstances. As she states in her attached affidavit, her family benefitted greatly from her transaction with Peachtree Settlement Funding which, in part, permitted her to obtain an automobile to facilitate her childrens' commute to work and school. She is employable and not disabled. Certainly she will lose her dignity if denied the right of self-determination and control over her own financial affairs.

2) Litigious Customers—The proponents of the excise tax offered testimony stating that our clients are so unhappy with our services that over 200 lawsuits have been filed against us as an industry. This assertion is absolutely false and reflects a gross misrepresentation to the Committee. Peachtree Settlement Funding has participated in several thousand transactions and has not been sued or served with a complaint by a single customer. Other NASP members have reported only a handful of customer initiated litigations out of 15,000 plus transactions. Unfortunately, a small percentage (1%) of our customers attempt to defraud us of payments we purchased. In these instances, we seek to enforce our purchase agreement against the individual perpetrating the fraud. The "200" lawsuits referenced by the proponents relate to those instances where a settlement purchaser instigated an action to enforce its contractual rights.

3) Searching Through Court Records—The proponents of the excise tax offered testimony stating that settlement purchasers, like Peachtree Settlement Funding, actively seek out and "target" accident victims. This assertion is absolutely false. No member of the National Association of Settlement Purchasers researches court filings or other court documents to identify potential customers. The mere suggestion of such is a red-herring and pure nonsense as over 80% of structured settlements are reached without a single document ever being filed in court. To the contrary, we advertise broadly without any specific knowledge as to whether those who hear

our message in fact have a structured settlement. We rely entirely on responding to inbound telephone inquiries initiated by the consumer.

4) Interest Rates—The proponents of the excise tax offered testimony stating that settlement purchasers, like Peachtree Settlement Funding, charge egregious interest rates. This assertion is false. Peachtree Settlement Funding utilizes interest rates consistent with credit card rates. These rates average in the high teens. The largest issuer of sub-prime credit cards in the country (First USA Bank) charges a standard rate of 26.1 percent. For the vast majority of our customers, the interest rates we charge reflect the best credit terms they have ever been offered. Moreover, our rates have declined steadily as competition in the industry has increased.

5) Consumer Bill of Rights—During my testimony, I referenced the National Association of Settlement Purchasers ("NASP") Consumer Bill of Rights. The Consumer Bill of Rights sets forth broad disclosure requirements and recission rights for the consumer. All NASP members are required to follow a code of ethics which includes compliance with the Consumer Bill of Rights. I have enclosed a copy of the NASP Consumer Bill of Rights and Code of Ethics for your consideration.

Thank you once again for the opportunity to make this submission to the Committee. I am available to provide additional information, testimony, or assist in any other manner to further the Committee's examination of the proposed legislation.

Sincerely,

TIMOTHY J. TRANKINA
President & C.E.O.

TJT:ma

Encl.

CONSUMER BILL OF RIGHTS

You have the right to know the exact amount you are to receive in exchange for your transfer of payment rights;

2. You have the right to know the discount rate applied to your transaction;
3. You have the right to consult with your counsel of choice at any time regarding your transaction;
4. You have the right to know the exact amount of all commissions, fees and other charges to be incurred by you in connection with your transaction;
5. You have the right to cancel your agreement to transfer your payment rights for any reason within three (3) business days of the date you receive payment;
6. You have the right to know about any penalty provisions, including claims for liquidated damages, in the event of a breach by you of your transfer agreement;
7. You have the right to choose whether or not to transfer your payment rights at any time.

NASP CODE OF ETHICS

Be it resolved, that the NASP shall adopt a code of ethics for its members. All members shall:

- Observe high standards of commercial honor and just and equitable principles of trade;
- Comply with all laws governing the member's operations, and shall conduct its business so that the member deserves and receives recognition as a good and law abiding citizen;
- Be accurate and complete in its contract negotiations with prospective customers;
- Not engage in any unfair methods of competitions; and
- Not take any unfair advantage of a prospective customer; and shall insure that the prospective customer is legally capable of entering into the transaction contemplated.

To Whom It May Concern:

I received payments pursuant to a structured settlement. This settlement arose out of a medical malpractice action from the death of my husband. My children receive a separate settlement which they will be able to collect when they turn 18 years old. I also receive social security payments and I am employable, if need be and I am not disabled in any way.

It is my understanding that the NSSTA has been using me as an example of how structured settlement purchaser take advantage of accident victims. First of all, I am offended by the NSSTA's position that I am incompetent to handle my financial matters. Secondly, my family greatly benefitted by doing transactions with Peachtree Settlement Funding. We used the money for several things: we purchased a vehicle which greatly facilitated my children's commute to school and to work. Also, we used a portion of the funds for recreation as we took a long due vacation in the island.

I am puzzled as to why I am being used as an example against structured settlement purchasers. Selling MY payments has benefitted me and my family and I do not think ANY insurance company has the right to tell me whether I should or should not do it, or whether I should or should not improve my family's life. I am perfectly capable to make these decisions on my own.

Thank you very much,

APRIL FELY

March 31, 1999

Notary Seal

State of Hawaii

County of Hawaii

On this 31 day of March, 1999, before me personally appeared April Fely

To me known to be the person———described in and who executed the foregoing instrument, and acknowledge that she executed the same as her free act and deed.

LAURI M. MATTOS
Notary Public, Third Judicial Circuit, State of Hawaii

My commission expires February 6, 2000

Chairman HOUGHTON. If I could just interrupt 1 minute. I mean it's the age-old issue. If it's a consumer protection issue versus an issue of law, then you have to make sure that the consumer is protected. If the industry is not going to do it, this is where the government moves in. I think most of us sitting around here don't want to create new laws.

But we will create new laws if the industry isn't willing to protect itself or it isn't able to protect itself. Maybe you have an answer to this, and maybe somebody else would like to make a comment.

Yes, Mr. Little.

Mr. LITTLE. Mr. Chairman, I would respectfully point out a case that Peachtree was involved in. I think it is important that we look at the circumstance of the claimant in each situation and not focus so much on language such as catastrophic. It would be a relative term that people would take exception to.

Let me give you the example here that I am speaking of. Her name is April Feely. Mrs. Feely is an unemployed widow, approximately 40 years old with eight children. Her sole source of income are or were her $1,200 monthly structured settlement annuity payment and Social Security payments of $1,850. The transaction for which Peachtree has sought approval from the Kentucky court as its fourth transaction with Ms. Feely. Taking the transactions together, she has sold Peachtree all of her monthly $1,200 settlement payments through February 2005, and all but $100 of her monthly payments through February 2008.

So, I think that case alone shows a circumstance. We are not talking about a catastrophic injury here. We are talking about a catastrophic situation, where she was dependent with eight children, on this annuity payment, in addition to her Social Security payment. It goes back to the Congressman Ramstad's comment of living one's life with dignity, free of government.

I can assure you that if this goes forward as proposed and Mrs. Feely is left without her annuity benefits, that she surely will be on public assistance, and she will surely lose some of her dignity in that regard.

Chairman HOUGHTON. Thank you very much.

Mr. COYNE. Thank you, Mr. Chairman. I just want to follow up. Mr. Trankina, what is the preferred method for payments to the companies' agents or salesmen?

Mr. TRANKINA. I am not sure I follow.

Mr. COYNE. Is it commission? Are they paid on a commission basis?

Mr. TRANKINA. Our employees?

Mr. COYNE. Yes, right.

Mr. TRANKINA. At Peachtree Settlement Funding, we have employees that receive a base salary a commission based on a sales volume, typical for a sales organization.

Mr. COYNE. The commission is based on sales volume?

Mr. TRANKINA. For that individual, yes.

Mr. COYNE. Along with a base salary?

Mr. TRANKINA. Yes.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Yes. I was just going to get back to my issue. Do you really have a feeling that the industry is going to be able to police itself? Because absent that, then clearly legislation is going to take place. Maybe the rest of you would have comments about it.

How about you, Ms. Kucenski?

Ms. KUCENSKI. I do not understand the question.

Mr. TRANKINA. If I may respond, if it please the Chair, if I may respond.

The industry is a young industry. We have responded to a calling of thousands of individuals, 30 percent of which never had any representation when they entered into the structured settlement, did not understand completely what the transaction——

Chairman HOUGHTON. Can I interrupt? Would you answer my question?

Mr. TRANKINA. Yes, sir. As a result of being an emerging industry, we have very diligently been organizing ourselves as a trade association, we have developed a consumer bill of rights and standards for membership in the organization. We believe those standards, which have not been submitted in the materials—I would appreciate the opportunity to do so. We believe those standards address the issues that have been raised.

Notwithstanding that, we do realize as an emerging industry, that others may want to get into the industry that may not choose to participate in our national association. For that reason, we have, as an industry, proposed a model act of legislation in various

States that would codify these types of consumer protections that we are all seeking.

We wholeheartedly embrace the idea of consumer protection, as long as it's meaningful and still provides and recognizes that circumstances change over time. Consumers had a choice when they entered into a transaction. They were victimized at that point, had a choice to take a lump sum or a structured settlement, and now later, as circumstances change, our typical timeframe is 5 to 7 years after an incident occurred, that they be given that choice once again to evaluate whether a financial transaction is in their best interest.

Chairman HOUGHTON. Would you have a comment on that, Mr. Chapoton?

Mr. CHAPOTON. No. I was simply going to make exactly that point. The industry is new. I have reviewed the Code of conduct that they have adopted and discussed with them at some length their effort at State legislation, where this should be dealt with.

Chairman HOUGHTON. And so you think that the Congress should wait, not pass legislation, and see this industry develop into greater maturity? Is that right?

Mr. CHAPOTON. That is correct. I think we should make sure that the industry does it responsibly.

Chairman HOUGHTON. How do we get away from something like that?

Mr. CHAPOTON. I think that is difficult, Mr. Chairman. I think highlighting situations like that is helpful, not harmful. I think the industry should deal with situations like that. As you say, it should police itself.

Chairman HOUGHTON. But is there anything we can do together to try to prevent something like this from happening tomorrow?

Mr. CHAPOTON. I would defer to Mr. Little, but I do think industry associations such as NASP are good ways to police industries. I think it should be done, and I hope and believe it is being done.

Chairman HOUGHTON. Mr. Little.

Mr. LITTLE. Mr. Chairman, we would have the opinion very strongly, sir, that 263 should be enacted for the very reason that you are asking the question, as I understand your question, sir.

We would be curious as to why even though it may be a young industry, that hundreds of purchase victims are suing the purchaser. If this is a legitimate business, and if it is serving some social good, why does all of this end up in such protracted lawsuits as we see, and are a matter of public record? Why are these interest rates so egregious? Why does it result in the stories that you see in U.S. News and World Report? Those are not isolated cases. We see it every day.

In my practice, I get to know a lot of very successful attorneys around the country. You would be surprised, sir, and somewhat impressed if you would hear the comments that they make.

That people come back to them after they have worked very diligently to procure the structured settlement, to protect the interest of their clients, their future medical needs, and see them come back 1 year, 2 years, or 5 years after the settlement and say "I'm totally broke. I sold my structured settlement. I squandered what I got for it. Is there anything that you can do for me?"

Chairman HOUGHTON. There isn't. I am all through with my questions.

Have you got any? Would you like to say something?

Mr. COLLINS. Yes, Mr. Chairman. I would like to ask Mr. Chapoton.

You mentioned what is occurring as far as what the association has drafted as their code of conduct and that State legislatures should look at this.

Mr. CHAPOTON. That's correct.

Mr. COLLINS. Are you familiar or are there any State legislatures that are actually looking at legislation like that?

Mr. CHAPOTON. There have been proposals. I really couldn't answer that directly. We could discuss that, but I couldn't give you any details on it.

Mr. COLLINS. But it is an industry that is an advantage for a lot of consumers who need help, who have structured settlements, to be able to go to an industry like this for assistance. But it is important that the State legislatures look at consumer protection legislation within their States.

Mr. CHAPOTON. That is correct. Our industry association supports that.

Mr. COLLINS. To me it is un-American for the Congress to try to tax any business out of existence, whether it be this type of industry or whether it be the tobacco industry, or whether it be an arms manufacturing industry or whatever. It is wrong to try to tax a business out of existence.

Thank you, Mr. Chairman, for allowing me to participate.

Chairman HOUGHTON. OK. Thanks, Mr. Collins.

Mr. McInnis.

Mr. MCINNIS. Thank you, Mr. Chairman. I have some appreciation for the gentleman at the end of the table. In the U.S. News and World Report interview where he talked for 45 minutes to the reporter and the reporter specifically left many of his comments out, I think everybody at this table has been a victim of that kind of reporting as well.

But Mr. Little, maybe you can help me out. What is the premium, the typical premium that is charged by these factoring companies to purchase the structured settlement? Can you give me an idea what? You said earlier extravagant interest rates. I happen to believe that is probably true, but I am trying to get my hands on a number here.

Mr. LITTLE. As a matter of public record, some of the things that the National Structured Settlement Trade Association through counsel has pulled, which show that a mortgage equivalent rate on an annual basis to range from 19.8 to 36.2, to 36.9, 41.7. Sir, I do not have an average for you. These are actual cases involving actual purchases. I would be happy to give you a copy of this.

Mr. MCINNIS. Reclaiming my time, Mr. Little. These are probably the most egregious cases because they filed litigation on them. I am trying to determine what is more run-of-the-mill. These are going to be at one end of it. If you have any data that would give me a run-of-the-mill rate, that would be a little more helpful to me than probably the most egregious cases.

Mr. LITTLE. I'm sorry, I don't have that with me today, sir. If we have any of that data available, we will certainly make it available to you.

Mr. MCINNIS. Then I guess the other point, Mr. Little, actually I find myself going back and forth with your testimony. I think it has been very helpful, and also the tax lawyer, I appreciate your counsel. But tell me at what point do you think that the client or the injured party should have the economic freedom to make a decision? If they make a bad decision, I mean who is responsible for that other than the person? Unless they have been sold through fraud or some other means, I mean at what point do you say hey, consumer beware. The same thing applies with charging on a credit card.

Mr. LITTLE. In my experience in working for many property and casualty companies and self-insureds, I don't see any fraud. The 104(a)(2) says damages received on account of personal injury or sickness, whether paid in a lump sum or periodic payments. Personal to the claimant, you have a choice. You can take it in a lump sum or you can take it in periodic payment. The property casualty adjustor who is sitting there at the settlement conference table is under no obligation to offer a structured settlement. He offers it as a choice, consistent with the tax law. So that is the moment of settlement there.

It is very, very rare that a case settles on a day that the settlement conference is held.

Mr. MCINNIS. Let me reclaim my time because I must have given you the wrong question. I am not talking about the original structured settlement. I am talking about the decision to factor their account or to go out and sell their structured settlement.

Mr. LITTLE. I think that our bill addresses that. I think with the showing of genuine hardship, that there would be no problem with that. I think it is reasonably foreseeable that there would be genuine hardship. I think if you go back the court of original jurisdiction, and you have the approval of that court, everything has been dealt with appropriately. The hardship has been demonstrated. The court has said yes, we understand the hardship and we let it go forward, and no excise tax is applied.

Mr. MCINNIS. Then I'll conclude it with this, Mr. Chairman. What if at some point somebody who is astute, who is not experiencing a hardship, sees that they can get a better return for their money; in other words, they had an opportunity to invest in a home in a rapidly accelerating real estate market. At what point would you allow those people to make a voluntary choice to sell a structured settlement to a factoring company, or sell it to the companies that do this, without having a hardship.

Mr. LITTLE. I would think in your example, sir, that it is part of the American dream to have a home. If an astute couple had an opportunity to buy a home, that that may fall under the genuine hardship.

I would find it a rare situation for a court of original jurisdiction to say if you have the opportunity as an American to own a home and you could do that, I would say that that would create a genuine hardship.

Mr. McINNIS. And help me. Would a person under this—because I'm not completely clear on this—what if a person can go and convince the court, I have got an opportunity to invest in a fairly conservative investment which will give me a higher return. Would they have to qualify—at what point could they say, Judge, I want to make my own decision. I want to sell the structured settlement.

Mr. LITTLE. I think, using your assumption, sir, that they were astute, that they had the opportunity to apply their astuteness at the time that they settled their lawsuit or their claim on the personal injury. That is the choice that they have at the time of the settlement, consistent with 104(a)(2) of the Code. As you are saying, if it's accelerated——

Mr. McINNIS. We don't play semantics here. The investment comes after the settlement. Forget the structured settlement. It has already been settled. Five years later, an opportunity comes up to invest. You know what I am saying.

Mr. LITTLE. Yes, sir, I do.

Mr. McINNIS. I am just trying to determine whether or not, if there is a lesser step, like perhaps just going to the court and the court determining that the party selling is fully aware of what they are doing, and the rate at which they are paying. I'll wrap it up.

Mr. LITTLE. I think at that point that you are unraveling the intent of Congress and a large body of tax law. I think that that would create problems.

You know, the Tax Code, I think that that narrow paragraph in there is the only segment of our society that you will find is protected in that way, are the profoundly injured. I think that if we undo that, we undo the intent of Congress, and we unravel all of that.

I hope I am answering your question. I feel like I am frustrating you in not answering your question, but that is my opinion.

Mr. McINNIS. Mr. Chairman, if I might, the gentlewoman there is kind of jumping around, anxious. Does she wish to respond, if it meets the approval of the Chairman?

Chairman HOUGHTON. Please.

Ms. KUCENSKI. When my husband and I decided to purchase this home, and it was exactly what you said, a great real estate opportunity, and we improved it and we made more money off of it, I took our money, my money made in Templeton Growth Fund, I am making more money, my money, making more than anybody could give me through what I have for settlement now. I had no choice to pick a structured settlement. I am 30 years old. I do not need this to physically improve myself or to live off of.

This is money that I found that me and my husband could invest in. That's what we did. It was basically my choice. I resent the fact that I had to have a judge grant me permission of my money to use it the way I saw fit. Basically it comes down to it's my money. I have the right to do what I want. If I blow it, I blow it. If I invest it wisely, great. But it is my money.

Mr. McINNIS. Thank you, Mr. Chairman.

Chairman HOUGHTON. All right, thank you very much. Thank you, I really appreciate your time here this afternoon.

[Whereupon, at 3:05 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of American Bankers Association

The American Bankers Association (ABA) is pleased to have an opportunity to submit this statement for the record regarding the tax treatment of structured settlements.

The American Bankers Association (ABA) is pleased to have an opportunity to submit this statement for the record regarding the tax treatment of structured settlements.

The American Bankers Association brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

The tax treatment of structured settlements is currently the focus of several legislative proposals. Representative Clay Shaw (R–FL) and others have introduced legislation, H.R. 263, *The Structured Settlement Protection Act of 1999,* to impose an excise tax on "persons who acquire structured settlement payments in factoring transactions." Also, the Administration's Fiscal Year 2000 budget contains a proposal to impose an excise tax on "the purchase of structured settlements." These proposals could have unintended and harmful consequences for banking institutions that make loans, pursuant to blanket security agreements, to consumers who receive structured settlement payments.

This could have unintended consequences on legitimate lending arrangements. If legislators determine to proceed with structured settlement legislation, such arrangements should be excluded.

THE PROPOSED LEGISLATION WOULD SUBJECT LEGITIMATE LENDING ACTIVITY TO A SUBSTANTIAL EXCISE TAX PENALTY

H.R. 263 would impose a 50 percent tax on "any person who acquires directly or indirectly structured settlement payment rights in a structured settlement factoring transaction." The bill defines a structured settlement factoring transaction is defined as "a transfer of structured settlement payment rights made for consideration by means of sale, assignment, pledge or other form of encumbrance or alienation for consideration." The bill provides that the tax should be applied to the "factoring discount," which it defines as "the excess of (i) the aggregate undiscounted amount of structured settlement payments being acquired in the structured settlement transaction, over (ii) the total amount actually paid by the acquirer to the person from whom such structured settlements are acquired." As currently drafted, the proposed legislation would impose a substantial excise tax penalty on legitimate lending activity.

For example, if an individual who borrows $100,000 from a bank, secured by a lien on the borrower's assets, is a recipient of annual structured settlement payments, the bank could be liable for an excise tax. The excise tax on such a transaction, assuming the borrower receives $20,000 per year for 15 years under the structured settlement arrangement, is as follows:

Face amount of settlement payments	$300,000
Loan amount	100,000
Factoring discount	200,000
Excise tax percentage	50%
Excise tax due	$100,000

The Administration's proposal is similar, but would impose a 40 percent excise tax on any person purchasing (or otherwise acquiring for consideration) a structured settlement payment stream. Under the Administration's proposal, the bank's excise tax liability could be $80,000.

Undiscounted value of purchased income stream	$300,000
Loan amount	100,000
Difference	200,000
Excise tax percentage	40%
Excise tax due	$80,000

The imposition of such substantial penalties on legitimate business activity would certainly not be an intended consequence of the subject legislation.

OUTSTANDING LOANS MADE PURSUANT TO BLANKET SECURITY AGREEMENTS COULD BE SUBJECT TO TAX

A blanket security agreement generally provides that the loan made by the lending institution is secured by all property (tangible and intangible) the borrower presently owns or subsequently acquires. As currently drafted, both of the proposals could impose excise taxes on banking institutions that use such agreements to secure loans. Indeed, a financial institution may unknowingly become subject to the excise tax on outstanding loans to a recipient of structured settlement payments upon rollover or renewal of the loan, or if the borrower acquires settlement payment rights subsequent to receiving the secured loan. The lending institution would be subject to tax even though it did not rely on the existence of the settlement for the decision to make the loan nor for repayment purposes.

Certain Members of Congress believe that by imposing the excise tax on the amount of the discount, rather than on the entire amount of the payment stream, the proposal is more targeted than the prior Administration proposal. However, for the reasons set out above, both proposals remain overly inclusive in that innocent and unknowing banking institutions may be unfairly snared in a punitive tax trap.

Further, enactment of the proposed legislation as currently drafted would impose new and unduly burdensome administrative costs on lenders, who would be required to re-write their outstanding loans in the attempt to avoid imposition of the excise tax. Accordingly, we strongly urge you not to impose the factoring excise tax on banking institution lending activity.

CONCLUSION

The ABA appreciates having this opportunity to present our views on the tax treatment of structured settlements. We look forward to working with you on this important matter.

Statement of American Council of Life Insurance

The American Council of Life Insurance (ACLI) supports H.R. 263, the Structured Settlement Protection Act ("Act"). We believe that this Act better regulates the factoring (i.e. purchasing) of structured settlement payment rights, offers greater protection to injured persons who are receiving those payments, and clarifies the effect on the insurance companies who issue the annuities from which the payments are made. The ACLI represents four hundred ninety-three (493) life insurance companies, many of which issue annuities that are utilized in connection with satisfying obligations to provide structured settlements payments.

Factoring Permitted with Finding of Court-Approved Hardship. Under the Act, an excise tax is imposed upon any person who acquires structured settlement payment rights except in the case of a transfer which is "undertaken pursuant to the order of the relevant court or administrative authority finding that the extraordinary, unanticipated, and imminent needs of the structured settlement recipient or his or her spouse or dependents render such a transfer appropriate." We believe that the requirement that a court or administrative agency make an affirmative finding of fact regarding the appropriateness of factoring structured settlement payment rights is crucial in ensuring that the intent of the underlying structured settlement is preserved.

Our member companies' experience has shown that structured settlements are often utilized in situations in which the recipient is physically disabled, in need of medical care, and may have a decreased ability to engage in gainful employment. The periodic payments from the structured settlement may be the main source of income available for support of the recipient and his or her family. Congress has recognized these concerns in the enactment of special tax rules which are beneficial to the structured settlement recipient, provided for primarily in sections 104 and 130 of the Internal Revenue Code. The legislation currently proposed would be consistent with the existing laws and would continue Congress' history of ensuring continued protection for injured persons receiving structured settlements.

In 1981, the original sponsor of section 130, Senator Max Baucus, noted that periodic payment settlements would "provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards." *Congressional Record* (daily ed.) 12/10/81 at S15005. The same needs exist today. The ACLI believes that the Act would serve both to strengthen the protections for injured persons intended by Senator Baucus in 1981 as well as to further the Congressional intent of existing legislation affecting structured settlements.

While the intent of a structured settlement is to ensure a steady income to an injured person, we also understand that an individual's circumstances can change and that there may be legitimate circumstances under which the factoring of a payment stream is appropriate for the injured person. The Act addresses these circumstances by providing that factoring is permitted without penalties where there has been a determination by a court or administrative agency that "extraordinary, unanticipated, and imminent needs of the structured settlement recipient or his or her spouse or dependents render such a transfer appropriate." The injured person is protected by having this determination made by a court or administrative agency familiar with the factual circumstances of each individual factoring transaction. The standard is broad enough to cover true hardships that we know do occur from time to time, while also being narrow enough to protect injured persons from dissipating their payment streams in inappropriate circumstances. This hardship standard falls within the ambit of the original 1981 intent of the structured settlement tax legislation.

Excise Tax. Our members prefer that factoring should be permitted only in cases of hardship as determined by a court or administrative agency. However, the Act does provide for a meaningful excise tax for factoring which occurs absent a finding of legitimate hardship. Any excise tax that is enacted must be of a sufficient amount as to discourage non-hardship factoring. In addition, any legislation must explicitly provide that the excise tax is to be paid by the settlement purchaser and that the amount of the tax is to be disclosed to the injured person.

Tax Clarification. The Act provides that "where the applicable requirements of section 72, 130, and 461(h) were satisfied at the time the structured settlement was entered into, the subsequent occurrence of a structured settlement factoring transaction shall not affect the application of the provisions of such sections to the parties to the structured settlement (including an assignee under a qualified assignment pursuant to section 130) in any taxable year." The ACLI believes that this provision is essential as it protects insurance companies issuing the structured settlement annuity contracts as well as the structured settlement obligors from unintended adverse tax consequences created by the actions of the injured persons and the transferee. At the time that the structured settlement annuity is entered into, insurers and obligors ensure that the qualified assignment underlying a structured settlement annuity contract will satisfy the requirements of the Internal Revenue Code, especially section 130. Were the tax treatment changed after issuance of the annuity contract due to actions beyond the control of the insurer or obligor, the insurer and obligor could incur significant financial loss. Since whether a payment stream is factored is based on a decision of the injured person and not on any decisions of the insurer or obligor, it would be grossly inequitable for a factoring to trigger a change in the tax treatment of the insurer or obligor. The Act appropriately takes into consideration this fact.

Conclusion. The Structured Settlement Protection Act should be enacted as it provides necessary limitations on the factoring of structured settlement payment rights while permitting factoring in true hardship situations.

Statement of Gerald D. Facciani, Henderson, Nevada

I appreciate the opportunity to provide written testimony regarding H. R. 263.

I am interested in this proposed legislation because of its potential negative impact on people *like me* who have suffered personal injuries and/or continue to be afflicted with physical disabilities. Some of these people have benefited substantively and substantially by being able to "monetize" (*i.e.* convert a series of fixed or variable annuity payments to a lump sum) part or all of a personal injury "structured settlement" to help meet certain financial needs.

Specifically, H. R. 263 would impose a 50% excise tax on certain types of financial transactions, known as "factoring" or "monetizing," relative to a fixed or variable series of structured settlement payments made to personal injury victims, many of whom remain partially disabled. I am opposed to such a provision being in the IRC for a number of reasons:

(1) H. R. 263 would prevent individuals who have suffered personal injuries -many of whom remain partially disabled -from monetizing a stream of fixed or variable payments made pursuant to a structured settlement arrangement. The vast majority of individuals who convert a series of payments to lump sums do so for important and critical financial reasons—e.g., to liquidate debts and avoid bankruptcy; to get a "fresh start" in life; to secure additional education or technical training; to capitalize a small business; to obtain the down payment for a home; etc. Only 3% of all structured settlement recipients monetize their payments, however for the majority of beneficiaries who choose to do so, access to monetization defines dignity, responsibility and freedom of choice. For such persons, the ability to convert part of their periodic payments spells HOPE! Why would any elected representative desire to circumscribe an individual's—and often a disabled individual's right—to achieve a modicum of financial dignity?

(2) An excise tax will act as a damper on future monetizing transactions, and therefore little, if any, revenue will be raised as a result of imposing such a tax.

(3) The small percentage of injured or disabled persons who will in the future engage in this transaction will encounter additional legal barriers, which in turn will cost them more (in the way of legal fees; higher interest rates due to increased transaction costs for factoring companies (also known as Settlement Purchasing Companies); *etc*) to access *their* money. End result: less money to those people—the injured and the disabled—who need it most.

(4) Not withstanding the availability of a hardship provision, to a person of limited means and legal experience, the process can be overwhelming, in addition to the expense of accessing such hardship provision.

(5) Do we really want to add to the load of our already overburdened judicial system?

Some proponents of H. R. 263 have a salutary reason for desiring enactment of this legislation, namely, to protect recipients of structured settlements against themselves and the "predatory" sales practices of a few sales people. Clearly, some individuals make choices they wish they had not made—haven't we all? Assuming strong underwriting and appropriate consumer protection safeguards can be implemented which will enhance a disabled/injury victim's ability to make an informed and protected choice regarding monetization, is this not preferable to having such persons pay an excise tax?

Other issues relative to monetization of structured settlements deal with (1) present value discounts to calculate lump sums and (2) legality of monetizing such payments. Regarding (1), interest rate discounts used by factoring companies, it is my understanding such rates normally fall into a range of 12% to 21%, depending upon the size of the settlement and the expenses associated with the transaction. For smaller amounts, the relative dollar cost to a factoring company is going to be greater than it would be for a larger dollar amount, because the fixed costs associated with a smaller transaction will comprise a greater percentage of the overall transaction's cost. A large portion of these fixed costs is attributable to the legal impediments raised by state and insurance companies! Finally, I know from personal experience as a disabled beneficiary under a group insurance contract, (and a former actuary-see Professional Credentials) that insurance company interest rates used to calculate "buyouts" of disability payments are equivalent to rates charged by factoring companies buying out personal injury claims.

Regarding (2), legal issues, Moody's rating service has established an asset class for factoring transactions, belieing the contention of those—principally insurance companies providing structured settlements,—who claim the assignment of a personal injury payment stream by a structured settlement beneficiary to a factoring company is not a qualified assignment. Furthermore, it is my understanding that the legal and tax validity of monetizing structured settlements has been *totally* buttressed by a tax opinion letter recently issued by Price Waterhouse Coopers to The National Association of Settlement Purchasers (NASP) 1

While my goal is not to assume an advocacy position for settlement purchasers, the best of these companies have worked diligently to develop and implement underwriting and consumer protection safeguards relative to monetization of structured settlement payments. Additionally, only about 3% of all structured settlements have been converted to some form of lump sum payment; and, as Moody's report illustrates, there have been relatively few illustrated examples of high pressure sales tactics.

The vast majority of structured settlement recipients are comfortable receiving a series of fixed or variable payments,—a steady stream of income meets their needs; however, for that small percentage of recipients, who both need and want access to some type of properly underwritten lump sum, monetization has been a valuable option.

On behalf of all injured and/or partially disabled persons, I urge Congress not to foreclose the option to convert part or all of a series of periodic payments to a lump sum. For the needy few (3%) structured settlement beneficiaries who have accessed monetization, its availability has helped and enabled them and their families achieve one of life's major goals—financial dignity.

Thank you very much

Statement of J.G. Wentworth, Philadelphia, Pennsylvania

J.G. Wentworth, located in Philadelphia, Pennsylvania, is a specialty finance company that originates, securitizes and services rights to receive payments from structured settlements and other deferred payment obligations. As the largest purchaser of structured settlements in the United States, we appreciate the opportunity to submit this statement for the record to the Committee on Ways and Means Subcommittee on Oversight hearing on the tax treatment of structured settlements.

A structured settlement describes an arrangement that compensates a plaintiff or claimant in a personal injury lawsuit over time, rather than with a current lump sum payment. Under the terms of the settlement agreement, the defendant and/or the defendant's insurer agree to and are obligated to make future payments to the claimant. The insurer also may elect to transfer the obligation under a qualified assignment to a structured settlement company and purchase an annuity contract to satisfy the periodic payment obligation.

Background

J.G. Wentworth (JGW) is in the business of purchasing, among other things, a portion of claimants' rights to receive future scheduled payments under structured settlement agreements. The purchase transactions undertaken by JGW provide liquidity to claimants whose structured settlements no longer meet their particular life circumstances. The need for JGW's funding services arises from the inflexible nature of many deferred payment plans and the changing financial needs of many claimants. Some claimants want to sell their payments rights because they have an immediate cash need and lack access to traditional funding sources. The claimant gains the advantage of realizing immediate liquidity on an otherwise illiquid asset. The purchase transaction is structured as a sale of payment rights under the underlying settlement agreement because the claimant is not technically the owner of the annuity contract and does not have the power to alter any terms except the name of the beneficiary and the address for payment.

JGW generally does not utilize brokers to originate structured settlement purchase transactions and its policies prohibit the solicitation or "cold calling" of prospective customers. Instead, JGW utilizes a nationwide television advertising campaign to provide information to claimants who might wish to sell the payments rights. The company's call center responds to claimant inquiries, attempts to quantify an individual's financial needs and endeavors to structure the funding transaction to meet those needs. JGW policies prohibit the origination of receivables from

[1] NASP is a 501 © trade association established by settlement purchasing companies to establish ethical and professional standards of conduct for the industry. The term "Settlement Purchasing Company" is used synonymously with "factoring company."

minors and incompetent persons and require independent representation by counsel of each claimant.

Since August 1995, JGW has consummated over 16,000 structured settlement transactions. By establishing the necessary infrastructure, including sound underwriting procedures and servicing capabilities, JGW has become the largest purchaser of structured settlements in the United States. Beginning in 1997, JGW has completed four securitization transactions through private placement of structured settlement-backed notes. To complete these transactions, JGW has sold a pool of structured settlements to a securitization trust which in turn issues debt that is sold to investors. Payments on the securitized receivables, less a servicing fee and certain related expenses, are made by the special purpose vehicle to investors. The most recent series of notes was at the time of initial issuance rated at "AAA" by Duff & Phelps Credit Rating Co. and Moody's Investors Services Inc., and was credit enhanced by MBIA.

PUBLIC POLICY CONCERNS

It is alleged that structured settlement purchases and, by implication, the actions of structured settlement purchasing companies such as JGW, undermine the public policy concerns that lead Congress to adopt special tax rules to encourage insurance companies to use structured settlements as a means to settle personal injury litigation. Let the record be clear that JGW emphatically believes that structured settlements are an appropriate vehicle to settle litigation or potential litigation. Structured settlements are especially effective to provide particular claimants with catastrophic injuries. However, the explosion in the use of structured settlements since the enactment of favorable tax legislation in 1982 belies the myth that structured settlements are used to protect catastrophically-injured individuals who are incapable of making informed financial decisions. Recent statistics indicate that between $5 and $10 billion in new structured settlements are generated annually. Information circulated by one of the largest structured settlement brokers states that over 50 percent of all cases structured in 1997 involved premiums of $50,000 or less and that only 12 percent included premiums over $250,000.

Other assertions made against structured settlement purchases allege the following:

• Structured settlement purchases trigger the very same dissipation risks that structured settlements are designed to avoid.

Untrue. JGW, and virtually every structured settlement purchasing company, As noted above, JGW attempts to quantify the need of a claimant before providing them with a variety of purchase options. Company statistics for calendar year 1998 transactions demonstrate that the average amount purchased was slightly over $16,000

• Structured settlement purchases often are made at sharp discounts.

Untrue. The average discount rate for structured settlement purchases has fallen steadily over the past two years. The most-recent statistics for the three months ended December 31, 1998 indicate that the average discount rate is 16.64 percent. JGW and the member companies of the National Association of Settlement Purchasers (NASP) firmly believe that discount rates will fall dramatically if appropriate measures can be enacted to further streamline and make clear that sales of structured settlements are permitted under appropriate circumstances. Consumers would be the ultimate beneficiaries from clarification of the tax and other rules that apply when settlements are purchased.

• Structured settlement purchasing companies prey upon the weakest, most gullible and most vulnerable in our society and engage in unconscionable, high-pressure marketing practices.

Untrue. JGW and NASP members have adopted a code of conduct and specific guidelines governing the sale of settlements. JGW will not purchase from minors, individuals who have been legally declared incompetent, or guardians (unless under court order); individuals who have been declared incompetent or guardians (unless under court order); individuals who depend on future payments for a medical treatment; the unemployed or unemployable whose payments are their only income.

JGW company statistics demonstrate that only 3 out of every 100 calls received by the company from individuals inquiring about potential sales ultimately result in a purchase transaction.

Prospective customers are fully apprised of the underwriting process and are advised of the requirement to consult with an attorney prior to signing and returning needed materials to JGW. Potential customers are advised in boldface documents that the transaction is a sale, not a loan and are advised to explore all appropriate financial options before entering into the purchase transaction. The documents furnished to each potential customer include a rate disclosure statement 1as well as a purchase agreement including a three-day right of rescission clause that remains effective after funding has occurred.

RECENT PUBLICITY

As the largest purchaser of structured settlements, JGW has become a "lightening rod" for those who would criticize a marketplace that permits consumers to choose to sell one of their assets to meet certain financial objectives. It is important to note that JGW is involved in a consumer business and each day interacts with hundreds of potential customers. As noted above, it is estimated that JGW enters into a purchase transaction with only 3 percent of those individuals that contact the company after viewing a JGW advertisement. JGW does not engage in "cold calling" and its independence from the broker community permits JGW to control the integrity of its origination process, avoid conflicts among origination channels and to provide more responsive customer service to claimants with legitimate requests for funding.

Earlier this year, *U.S. News & World Report (U.S. News)* published a story entitled "Settling for Less—Should accident victims sell their monthly payouts?" (January 25, 1999, pp. 62–66). That story includes four examples of individuals who engaged in purchase transactions with JGW and now express dissatisfaction with the company. There are compelling facts that were not included in the article about each of the individuals identified in the article. Importantly, notwithstanding each individual's serious physical difficulty, none of the individuals were, at the time they entered into their transaction with JGW, mentally incompetent or unable to work. In each case, JGW responded to the needs of the individuals as expressed on their application form. Moreover, in each case, the individual described in the article actively defrauded JGW by keeping or diverting payments purchased by JGW. Accordingly, JGW asserted its rights.

Specifically, one individual, who was homeless when he contacted JGW, engaged in two transactions with the company after expressing a need to use the funds to assist with his living arrangements. A second individual sold roughly one-third of her future payments, entering into the transaction after being taken advantage of by friends and family members and after defaulting on a series of prior loans with banks that would not lend against her settlement. A third individual received a lump sum from JGW but continued to receive payments from the annuity company, keeping the payments purchased by JGW. During a two-month period, JGW attempted to work with the individual (even offering to forgive certain payments it did not receive) to direct the payments to JGW as he was contractually required. Only after these repeated attempts failed did JGW utilize a confession of judgment remedy to which the company was entitled. A fourth individual mentioned in the story has, by his own admission, been receiving payments that JGW has purchased. The annuity company had continued to send payments to his address. Again, JGW attempted to work with the individual and has also offered to completely unwind the purchase transaction, even allowing him to keep JGW's lump sum payment. He has refused, choosing instead to pursue litigation against the company.

The *U.S. News* article and criticism from others makes reference to the fact that JGW uses confession of judgment in limited circumstances. In testimony aimed at putting companies such as JGW out of business, groups such as the National Spinal Cord Injury Association assert that JGW uses "unethical legal maneuvers and stratagems such as the use of a confessed judgment against the victim in a distant court to garnish the victim's payments. This remedy is legal in Pennsylvania and several other states. Courts in New Jersey and California (the only two instances in which this remedy has been challenged) have upheld its use in terms of due process. JGW follows the Pennsylvania Rules of Civil Procedure to ensure certain protections such as service and notice are afforded to the claimant who has sold payments and complied with its underwriting and documentation. In fact, JGW provides an additional protection not required by the Rules of Civil Procedure by both sending notice to the claimant of the filing of the papers by both certified and regular mail. Moreover, it is a remedy that JGW employs only if there has been intentional, active fraud by a claimant. JGW will only confess upon a default under the terms of its documents, and does so only after its Customer Services and Collections departments have attempted to resolve the matter amicably. To date, no judgments obtained have ever been exercised against a claimant directly, other than by garnishing the annuity against the annuity payor.

CONSUMER PROTECTION

As the largest purchaser of structured settlements in the United States, JGW joins with its fellow NASP members in embracing meaningful consumer protection standards and regulations. JGW fully supports NASP-sponsored legislative initiatives which provide major safeguards for consumers and protects their rights to make their own financial decisions. Such initiatives are currently underway in over twenty different state legislatures. Consumers deserve the right to choose whether or not to receive a lump sum or a structured settlement payment. This choice should be available, both during settlement negotiations and years later. Claimants who decide to receive a structured settlement should have the right to sell that payment, not be forced to continue with inflexible periodic payments that do not meet their needs.

LIBERTY FUNDING CORP.,
4303 LIBERTY AVENUE
NORTH BERGEN, NJ 07047
April 14, 1999

The Honorable A.L. Singleton, Chief of Staff
Committee on Ways and Means
United States of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Representative Singleton:

I urge you to proceed with extreme prudence concerning proposed bill H.R. 263 until all of the data necessary to make an educated and unbiased decision as to the validity of the assertions contrived by the NSSTA (National Structured Settlement Trade Association) have been attained. Until now, only the NSSTA's unsubstantiated allegations regarding our effort to *Re-Structure* structured settlements have been heard by committee members. I am sure that as a highly-respected member of congress you would prefer to have all of the facts prior to forming your opinion, and I trust that you will make a concerted effort to be as fair and impartial as possible.

This sense of fair play can only be achieved by courteously granting us the opportunity to present our position and evidence thereof. Prior to committing to a hasty, biased decision, please take some time to consider the devastating affect that this bill would have upon the thousands of people this industry employs, and more importantly, cautiously consider the onerous consequences which will be forced upon the very people that the NSSTA are reportedly attempting to protect, but may in fact be victimizing once again.

As an employee of a Settlement Purchasing company I find the term "gray market," coined by the NSSTA, insulting and unsubstantiated. NSSTA members are virtually comprised of insurance brokers (a/k/a middlemen) whose high-pressure tactics force clients, often without the benefit of legal counsel, to commit to a settlement wherein they will receive their payments in future installments. These brokers are not required to disclose the current value of the settlement (i.e. purchase price of the annuity), nor do they inform these unwitting clients that they (the brokers) are being paid a commission fee for negotiating the settlement. I do not wish to demean the NSSTA, as they are in the business of making money, albeit from another's misfortune. However, before they can accuse factoring companies of exploitation, I suggest that they first look in the mirror. If ever there was a case of the "pot calling the kettle *gray,"* this is surely it!

I am still at a loss as to why the NSSTA and certain insurance companies are opposed to our business, except for the fact that we are enlightening the public as to the true "time value of money"! Purchasing the right to receive payments does not affect their tax status, nor does it keep potential clients from accepting installment payments as a condition of the settlement. In fact, we make an effort to inform plaintiff attorneys of our existence and encourage them to advise their clients that should the need arise, there are options available to them in the future. Most of these attorneys have expressed to me that because an option exists allowing these clients to re-structure their structured settlement, the clients have been more willing to agree to settle via a structured settlement than they have in the past.

Our industry has recognized the need for people with limited access to traditional sources of capital to have an alternative. A vast majority of our clients are minorities and/or are in low or moderate income households. The NSSTA is of the opinion that families are being "held together by a structured settlement." In some instances this may be true, and if the circumstances are such that the client has no other means of support, under our self-imposed regulations those individuals are usually denied for funding, or are limited to assigning only a minimal portion of their periodic payment. In essence the best of both worlds; they have the benefit of a lump sum now, in addition to the security of continuing to receive most of their installment payments. Our decisions as to who is approved for funding and who is not, has a great deal to do with the client's well-being and their ability to live within the terms of the transaction, without government assistance and/or resorting to bankruptcy. In fact, we have saved numerous people from bankruptcy, so that they do not have to rely on already overburdened entitlement programs for support.

All of our potential clients are subject to intense scrutiny as to their financial obligations. As a prerequisite to funding, they must authorize a complete background search including outstanding judgments, liens, child-support payments and the like. The searches are complete and thorough, and outstanding debts must be satisfied prior to funding, including but not limited to, child-support arrears, tax liens and overdue mortgage payments.

Since structured settlements cannot be used as collateral by the client because the insurance company, *not* the client, usually "owns" the annuity, our industry has afforded clients their only means of obtaining money now in order to address a financial concern. Some of the items the money has been applied to include; debt consolidation, health emergencies, college/trade school tuition, down-payments on homes, business opportunities, foreclosure aversions, farm equipment and transportation.

Most clients are not aware that the insurance company can assign the obligation to pay (via Qualified Assignment) to an entity other than themselves. This provides no benefit to the client, but rather it allows the insurance company an opportunity to capitalize on the favorable tax incentives provided to the insurance industry. Additionally, the client has not been told that in the event that the assignor becomes insolvent, as with Executive Life and Confederation Life, who are currently in rehabilitation, the client will be unable to sell their payments and reinvest in treasury bonds or similar, more secure investments.

Despite obvious problems within the insurance industry, I am obviously not opposed to settling personal injury claims via structured settlements. At the time of the settlement, installment payments may have been the best course of action, but circumstances often change. Unfortunately, structured settlements do not provide for those changes and can do more harm than good for those in immediate need of money to which they are rightfully entitled. In a free society, it is up to the individual to determine what is right for them, and by imposing a 50% excise tax on our industry, particularly in light of the current budget surplus, you will be adversely affecting those who can least afford it by virtually severing the only option available to them. I feel that by imposing this unfair excise tax, you will have infringed upon an individual's right to freedom of choice, and on our right to free enterprise.

I do not want to lose my job, and I am confident that you will not rush to judgment. Thank you for your time and consideration.

Sincerely,

LISA TERLIZZI
Owner

FURY NARDONE
Sales Representative

DOREEN KIRCHOFF
Office Manager

LEE ANNE RIZZOTTO
Sales Manager

HOGAN & HARTSON L.L.P.
COLUMBIA SQUARE
555 THIRTEENTH STREET, NW.
WASHINGTON, DC 20004–1109
March 31, 1999

BY HAND DELIVERY

Hon. Amo Houghton, Jr.
Chairman
Subcommittee on Oversight
House Committee on Ways and Means
1136 Longworth House Office Building
Washington, DC 205l5

Re: Follow-Up Submissions for Hearing Record of March 18 Oversight Subcommittee Hearing on Structured Settlement Factoring

Dear Chairman Houghton:

Enclosed for filing as part of the hearing record for the March 18 hearing held by the Oversight Subcommittee on the tax treatment of structured settlements and structured settlement factoring are 6 copies (and a disk in Word Perfect 5.1 format, where possible) of the following documents:

(1) A memorandum of the National Structured Settlements Trade Association entitled, "Point-Counterpoint—Responses to Assertions Made by Factoring Companies Regarding the Factoring of Structured Settlements," dated March 25, 1999 (document on hard copy and disk);

(2) A memorandum of Hogan & Hartson L.L.P. entitled, "Overview of Tax Concerns Raised for Structured Settlements by Factoring Transactions," dated March 24, 1999 (document on hard copy and disk);

(3) A memorandum of Hogan & Hartson L.L.P. entitled, "March 18 Oversight Subcommittee Hearing on Structured Settlement Factoring—The Commonwealth of Pennsylvania Medical Professional Liability Catastrophe Loss Fund's Experience with the Factoring Companies," dated March 25, 1999, to which is attached the brief of the Medical Professional Liability Catastrophe Loss Fund before the Supreme Court of Pennsylvania in the case of *Legal Capital, LLC and Charles I. Artz v. Medical Professional Liability Catastrophe Loss Fund*. (The memorandum of Hogan & Hartson L.L.P. is provided on both hard copy and disk; the attached brief is provided on hard copy only).

(4) A letter from Hogan & Hartson L.L.P. to Hon. Scott McInnis, dated March 19, 1999 responding to a question that he raised during the March 18 hearing regarding factoring company discount rates, together with attachments to the letter: (i) a document entitled, "Discount Rates Charged to Settlement Recipients in Factoring Transactions (Drawn from Court Records)," dated March 15, 1999; and (ii) a document entitled, "Factoring Companies Routinely Sue their Own Customers, Obtaining Judgments in Amounts That Dwarf the Amounts the Customers Have Received," dated February, 1999, to which is attached a series of court docket sheets. (All of these documents, with the exception of the court docket sheets, are provided on both hard copy and disk; the court docket sheets are provided on hard copy only);

(5) A series of sample factoring company advertisements offering to purchase structured settlement payments. (These documents are provided on hard copy only);

(6) A memorandum of Hogan & Hartson L.L.P. entitled, "Presentation of Cost Information to Injured Victim at Time of Structured Settlement Offer," dated March 25, 1999, to which is attached a series of four examples of the detailed structured settlement illustrations that are presented to the victim and counsel during the settlement negotiations. (The memorandum of Hogan & Hartson L.L.P. is provided on both hard copy and disk; the attached structured settlement illustrations are provided on hard copy only); and

(7) Relevant portions of two studies prepared by the Insurance Services Office, Inc. entitled "Closed Claim Survey for Commercial General Liability: Survey Results, 1997" and "Closed Claim Survey for Commercial General Liability: Survey Results, 1995." (These documents are provided on hard copy only).

Sincerely,

JOHN S. STANTON

Enclosures

cc: Hon. William J. Coyne
Ranking Minority Member
Subcommittee on Oversight
House Committee on Ways and Means—Minority Office
1106 Longworth House Office Building

[Attachments to this letter and an additional letter and attachments are being retained in the Committee files.]

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