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The Beginnings of Structured Settlements

By [Denise Johnson](#) | August 5, 2013

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Currently an estimated \$5 billion industry, structured settlements were once considered too risky because tax implications for insurers and claimants hadn't been ironed out.

According to Peter Arnold, deputy director of the National Structured Settlements Trade Association (NSSTA) based in Washington D.C., the creation of a federal tax code recognizing structured settlement annuities 30 years ago paved the way for the increased use of structured settlements in bodily injury claims negotiations today.

When Senator Max Baucus, D-Mont., current chairman of the Senate Finance committee, recently announced that he would not seek re-election in 2014, many in the structured settlement industry began to reflect on his contribution to the tax-free vehicles.

"Early in his career, Sen. Baucus had a critical role in passing legislation that for the first time ever clarified the ability of physically injured accident survivors (and dependents in wrongful death cases) to choose a secure stream of tailored payments (a structured settlement) instead of a lump sum," Arnold stated.

In 1982, Congress adopted specific tax rules to encourage the use of structured settlements to resolve physical injury cases known as the Periodic Payment Settlement Tax Act, according to the NSSTA. Section 104(a)(2) of the Internal Revenue Code clarified that the full amount of the structured settlement payments was tax-free to the victim.

Len Blonder, a Los Angeles-based settlement consultant with EPS Settlements Group, Inc., began working in the structured settlements business prior to the federal tax code change.

"He saw firsthand how claims settlements changed once the federal government clarified the tax treatment of periodic payments," Arnold said.

The beginnings of structured settlements can be traced back to the early 1970s. During that time, insurers began having to consider future medical treatment on injury and medical malpractice claims.

According to Blonder, the founder of the structured settlements industry was Jerry Sullivan, who still is involved in the business today as chairman of The Sullivan Group, a Los Angeles-based privately held consortium of independent, insurance-related companies.

“The basic concept behind the use of structures or periodic payments...is to provide protection for injured parties,” Sullivan said.

In the 70’s, the tax code stated that payments for personal injuries were excludable from income tax but it did not specify how the payments could be disbursed.

Industry insiders wondered what would happen if payments were paid out over time?

In 1974, an accounting firm researched the issue and found that as long as a claimant didn’t have either constructive or actual receipt of the money, the payments would be considered tax-free. In addition, because a defendant isn’t interested in paying money out of its own funds, the interest element in the annuity would also be tax-free to the claimant.

According to Blonder, in 1979 the Internal Revenue Service came out with a revenue ruling that essentially said the same thing.

“If you agree to make periodic payments, and if you either make them yourself – the defendant or the insurer – or you buy an annuity, the payments are all tax-free, including the interest element,” Blonder said.

At that point, to structure a settlement the defendant, or its insurer, would own the annuity and have the obligation to make the payment for as long as the payment obligation existed.

But according to Blonder there was still some ambiguity surrounding their use.

“There was a question as to how casualty companies were to account for it and how self-insureds were to account for it on their books. There was some idea that a self-insured could gross up the entire periodic payments that they owed and deduct that amount from their current income,” Blonder said. “The IRS didn’t like that idea. How does the insurance company account for it?”

That’s when the Periodic Payment Settlement Tax Act of 1982, which Senator Baucus was a key player in, came into the picture. It allowed defendants to enter into what’s now called a ‘qualified assignment’, he said.

The federal legislation said that if a self-insured were to buy an annuity themselves, they could not deduct the cost of the annuity during the year they purchased it.

“They would only be able to deduct part of the payments as the periodic payments were made, which would make it very, very unattractive for self-insureds to enter into a structured settlement,” Blonder said.

That law also allowed both defendants and their insurers that entered into a qualified assignment to take those payments off their books.

“The advantage to the plaintiff was they wouldn’t be looking at relatively less-secure casualty companies, as opposed to the life insurance companies that are in our industry, which are much stronger and much more secure than casualty companies, or certainly self-insureds, typically,” Blonder said,

The Act provided clarification for all parties involved.

“If they’re done correctly, the way structures work is you sit down between the plaintiffs and the defendant, and you work out an agreement to provide so much in the way of funding at whatever levels are required. That can be as limited as your imagination. Then you back that by an annuity. OK, why do you do that? The reason you do that is an annuity is the only tool under law that you can use where payment is based on mortality,” said Sullivan. “People have tried to fund periodic payments with bonds, and other things, et cetera, and they all get wrapped up in the investment income stuff. It’s not an investment income gain. It’s protecting the injured party.”

Structured settlements don’t just benefit the injured party, they also benefit the insurer.

“Now at the same time, if the structures are handled correctly, and not everybody handles them very well, the casualty company doesn’t end up paying out as much money as they might otherwise. But they provide better protection. What does that mean? That means the premiums don’t go up as much as they might otherwise. All in all it’s a win-win situation if they’re used correctly,” Sullivan added.

Blonder said that the Act clarified the tax status for the defendants, allowed insurers to enter into a structured settlement without having an ongoing obligation and allowed plaintiffs to have a more secure obligor.

Besides tax-free payments, another benefit of a structured settlement is to control the amount of money distributed over time.

“Unfortunately, oftentimes, people who get a large amount of money don’t spend it wisely. Their friends and relatives borrow the money. Somebody who’s never made a lot of money, all of a sudden they have a million dollars. They think that’s more money than there is in the world, they can never go through it. Of course, that’s not the case,” said Blonder.

Jim Early of Ringler Associates, who has been involved in claims and structured settlement work since the late ‘70s, said that the change in federal tax affected claims work.

“I was around for a very little while before we had the codification that we got with the law. There were some questions on all the structured settlements as to what the liability would be for those who owned them, what we used to call the ‘buy and hold’ annuities,” said Early.

The Ringler representative said that Senator Baucus’ role in clearing up ambiguity with structured settlements was to give definitive closure for both sides of the case.

“The creation of the qualified assignment allowed for a defendant to extinguish its obligation by getting a structured settlement, putting it with a qualified assignee and removed any concern about what the future obligations were of the defendant to the plaintiff. The plaintiff no longer had to look to the defendant for the ultimate security but to a subsidiary of a life insurance company, which was the final security and certainty that every plaintiff wants and the corresponding closure that every defendant wants,” Early said.

The tax code implementation made it easier to determine where liability or the responsibility would rest for structured settlements.

“It really was what allowed [structured settlements to become the viable vehicle that they are today for injured people](#). Structured settlements now, it was clear to both sides that the defendant got the closure that it needed on a case, and the plaintiff got the security that they needed over the long run. It was a wonderful solution. Clearly inherent to the benefit of injured parties, because there was certainty now where there was a little bit of an uncertainty before Senator Baucus led the charge on the legislation,” said Early.

The clarification helped one future congressman during settlement negotiations on his injury claim. When Early was a claim manager for an insurance company in Rhode Island, he became involved in closing a case for a Jim Langevin, a young man who had been working with the Warwick Police Department when he was injured by an accidental firearm discharge. Langevin would later go on to be Congressman Langevin.

“I said, ‘boy, this is a perfect case for a structured settlement.’ We collectively put our heads together and came up with a solution that involved a structured settlement for Congressman Langevin,” Early said.

Congressman Langevin provided a statement to *Claims Journal* regarding his injury:

“When I was 16, I served as a police cadet in the Boy Scouts Explorer program. At the beginning of a shift, I was in the police locker room where two officers were looking at a new gun. The clip had been removed, but unbeknownst to them, there was a still bullet in the chamber. One of the officers pulled the trigger and the gun went off. The bullet ricocheted off a locker and severed my spinal cord, leaving me paralyzed.”

“After my accident, choosing a structured settlement freed me from the burden of making difficult investment decisions all at once with settlement funds meant to secure my future. Having the opportunity to determine which investment options were the best for me over time not only allowed me to manage my money wisely, but gave me and my family peace of mind.

“I always take the opportunity to educate my colleagues on the benefits of structured settlements to injured victims. These settlements ensure that victims have enough funds not only to pay their bills today, but also in the future. They provide economic security not found in a normal legal settlement.

Blonder and Early are proud of their work with structured settlements.

“I kind of enjoyed watching his career in that, knowing that I had some small part in his growing into a young adult with certain securities in his life that allowed him to run first, if memory serves me right, as a state representative. Then, I believe, he might have even been the state treasurer in Rhode Island, and then eventually became a congressman from Rhode Island,” Early said.

“Nobody knows the future, but you look at the life-care plans and you try to coordinate for what benefits might be needed when and things like that. From my point of view, it’s quite a rewarding situation for me to have been in. I look at it and I know that if somebody who’s injured takes a structured settlement, they’re going to be OK, and it really gives me a sense of pride in what I do,” said Blonder.

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