

Selling Your Structured Settlement – What You Need to Know and the Truth Behind the “It’s My Money and I Need It Now” Ads

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People sometimes get into tough financial situations and will need to access funds they would be better off leaving alone. From the relatively straightforward process of borrowing from your own 401(k) to the more nebulous payday loan shops, there is a steep financial price to pay when accessing funds this way.

One such financier of last resort are factoring companies, which run the gamut in buying up cash flows, from lottery winnings to pensions. A source of business for them is the buying of structured settlements. Many people have seen the ads on television with people screaming “it’s my money and I need it now” to opera singing Vikings on a bus. What the ads don’t tell you is the process itself is neither quick nor easy, has significant legal fees that you will pay for, with a number of pitfalls along the way that anyone contemplating such a sale should be mindful of. Choosing such an option to obtain funds should always be a last resort for anyone and done only for the most extreme needs.

A structured settlement is an injury settlement where some part of the proceeds are to be paid over time, most often funded through the purchase of annuity. In order to retain all of the tax free benefits of a structured settlement, the injured party, or payee, can only receive the payments as they are scheduled to be paid. Unlike a retail annuity purchased and owned by a person, a structured settlement annuity has no withdrawal or termination features. This has led to the factoring, or selling, of structured settlements when people are in need of immediate cash. In return for a discounted lump sum, a factoring company will purchase the future structured settlement payments upon obtaining court approval. This court approval is required under the state Structured Settlement Protection Act, or SSPA. No factoring transaction should occur without court approval.

Anyone with a structured settlement should carefully consider whether to factor or not, and if they do, what things to ask for and be wary of. What follows is a brief list of things for someone to consider before entering into a factoring transaction:

Timing

The television ads that scream “it’s my money and I need it now” don’t tell the full story. You don’t get your money now. You’ll get it several months down the road. There are, depending on the state, any number of steps to follow, including a mandatory disclosure notice, the sales contract itself, and the court hearing to approve the transaction¹. It isn’t like going to the bank and making a withdrawal from the ATM. It is a lengthy and often complicated process, even in

¹ While there are many similarities between states, each state SSPA is unique. Statements regarding appearance, timing and location are generalized and actual requirements will vary from state to state. Check with your attorney regarding specifics in your state.

the speediest jurisdiction. Some factoring companies will provide an advance of some of the funds, but this does not shorten the overall approval process.

Future Value, Present Value and Discount Rate – What Does It All Mean?

Even financial professionals will struggle with these concepts, but they are key to determining how steep the cost is, and in turn, if the transaction is right for you. The future value is the total of the annuity payments you are to receive over time. Present value is what those future payments are worth in today's dollars, at a stated discount rate. A discount rate is an interest rate applied to the future payments to come up with the present value.

The easiest way to think about present value is to look at a home mortgage. If you borrow \$200,000 to buy a home and get a 30 year mortgage at 4.3% interest, you will have a monthly mortgage payment of \$1,000 per month for the next 30 years. To put that in annuity terms, you have a future value of \$360,000 (\$1,000 per month x 360 payments), with a present value of \$200,000 (the mortgage amount) using a 4.3% discount rate (the interest rate).

Once you have a present value, you should try to get the highest amount you can. Like any retailer, factoring companies will differ in price from company to company. If a factoring company A were to offer \$130,000 for the above payment stream, factoring company B were to offer \$150,000 and bank C were willing to loan you \$175,000 for the same payment stream, from a financial standpoint you would go with the bank option.

You should check (or rather, have your financial advisor check) that the discount rate is appropriate and that the final offer is a reasonable percentage of the present value.

The “best interest” standard

A structured settlement can't be sold or borrowed against unless the court determines that the sale or loan is in a person's best interest. This standard only permits a court to approve the sale or loan if the person can demonstrate it is in his best interest to receive a lump sum payment for his structured settlement. The primary function of the SSPA's is to protect you, the consumer. While courts have approved sales and loans for such things as medical expenses, housing or education, they have denied transfers for things like paying off credit cards, getting elective surgery like Lasik, or if the discount being charged by the factoring company is too high.

Check with your annuity company first

Structured settlements are funded by annuities issued by large, highly rated life insurance companies. Several of these companies will utilize the same SSPA and provide a commutation or acceleration of the annuity payments. Call the company that issued your annuity first to see if this is an option. The annuity issuers are doing this as an enhancement to the annuity they've already sold, and in most, if not all cases, will offer a payout superior to that of a factoring company.

Check with a bank

Many banks offer unsecured loans and may look at the annuity as a source of income, much the same way they will view a copy of your paycheck or W-2. While these rates are higher than a secured loan (like a mortgage) they are very often superior to the rates a factoring company will charge, assuming you have good credit and qualify for a loan. A copy of the annuity contract is typically all that is needed to document the income.

Beyond that, some banks, most notably Esquire Bank (www.esquirebank.com) in New York and Midland States Bank (www.midlandsb.com) in Illinois, will use the same SSPA and obtain a security interest in the annuity and provide a secured loan, which equates to lower interest rates. Like all loans, they are regulated by state law, as well as having regulatory oversight by the FDIC, OTS and state banking commissions.

Price Comparison

Anyone making a major purchase would not hesitate to comparison shop; given this is one of the largest and most important financial decisions you'll make, it would be prudent to comparison shop on the rate being used. Prices and amounts can vary widely, yet few annuitants will price shop before entering into a factoring transaction.

Independent Financial Advice

A requirement under many of the state SSPA's is for a person to have independent financial advice regarding the factoring transaction. Unfortunately, most people will waive this when allowed and deprive themselves of an independent review. These are complex legal and financial transactions with long term repercussions on your finances, yet most people will not seek independent advice. If you don't have a financial advisor, you may want to start with the structured settlement consultant who set up your annuity, or if you were represented by an attorney for your settlement, check with your attorney.

The Court Approval – Whose Lawyer Is It?

Once you have decided on a course of action (annuity company, bank or factoring company), a court hearing to approve the transaction will be one of the last steps in the process. The factoring company will generally hire an attorney to complete the transfer, but this lawyer is typically paid for by you in the form of fees and costs deducted from your lump sum. Look for the amount of fees and costs to be sure they are fair and reasonable. Remember, the lawyer is there to get the transaction approved for the factoring company or bank, not to represent you or your interests.

Be Sure of the Amount

Factoring companies make a lot of money on "repeat business," or annuitants who factor some of their annuity, then go back later and factor more. The problem with this is that you will incur a whole new set of legal fees and costs each time you do this. When talking to your financial advisor or attorney, determine exactly how much you need for your current and future needs and do one transaction, not multiple ones. It's far more cost effective that way.

The Court Hearing

Many states will permit a waiver of personal appearance. You should never waive this appearance absent extreme circumstances. This is one of the most important financial decisions you will ever make and you should be present for the hearing. You're paying for it, after all. The judge may also want to ask you questions regarding your payments and how you plan to spend the money and how you plan to live without the guaranteed future income from the structured settlement.

Where the Hearing is Held

We have seen some jurisdictions where the hearing is held in some remote county on the other side of the state, making it hard for a person to get to, making it more convenient to waive your personal appearance on this important transaction. You should insist the court hearing should be held in the county where you reside. There is no reason for the company not to. Be wary of a company that files across the state, hundreds of miles from where you live.

Final Thoughts

The decision to sell or borrow against your structured settlement is a major financial and legal decision, and should not be entered into lightly, but may be necessary given the uncertainties we all face in life. Like any industry, there is a wide range of prices and quality when it comes to selling or borrowing against your structured settlement. Should such a decision become necessary, get sound advice and compare the options before you commit. Your financial future depends on it.

The author is a structured settlement consultant with EPS Settlements Group, Inc. The article is not to advocate the factoring of a structured settlement but rather to increase awareness of the issues involved in the transaction. The information regarding SSPA's will differ from actual use in a particular jurisdiction, based upon state law and the specific facts of each person's situation. This article is not intended as nor may it be construed as legal advice. Consult with your own legal counsel for advice.