

Settlement of Future Loss Elements for Cash

The Burbank Group

We previously mentioned that Liability Insurers are in a really strange world. In addition to low 10-Year Treasury rates and issues with their investments, they are required to guarantee the stream of future payments incorporated in a verdict by providing annuities. Short term future Awards often have a net value that is insufficient to provide for the required payments and any normal fees.

The first payment for any future damages element is determined by dividing undiscounted future Award after adjustment for lump sum distributions by the element's period of future loss, in months. The result is then further reduced by expense and fee rates, and any initial Collateral Source offset payment.

The amount employed to purchase an annuity is the element's discounted Award, reduced by expense and fee rates and the discounted value of any Collateral Source offset.

Exclusive use of annuities result in a number of separate contracts some with modest payout terms, and the Court has recognized that annuity streams dictated by the statutes are not meant to meet any of the plaintiff's needs. The short tem payment streams often result in small percentage returns under any version of the statutes.

We modified our valuation models first to calculate an overall return rate for each of the elements of future loss, as if they had been annuitized, and then to pay the stream through a taxable trust invested in 'AAA' or 'BAA' corporate bonds.

The return rate is a proxy for the amount of money earned and which would be otherwise taxable to the plaintiff.

<u>Elements</u>	<u>Payment Period</u>	<u>Overall Rate of Return</u>		
		<u>50B</u>	<u>50A</u>	<u>Amend 50A</u>
Pain and Suffering	8 Years		18.2%	18.2%
Pain and Suffering	10 Years	23.5%		
L.T. Medical Care	15 Years, 10 months	34.8%	38.9%	30.7%
Rec/Correct Surgery	15 Years	38.1%	38.1%	33.9%
Orth. and Prost.	14 Years	35.0%	35.0%	31.5%
Ambulatory Devs.	15 Years	38.1%	38.1%	33.9%
Lost or impaired Earnings	30 Years, 10 months	121.6%	121.9%	91.6%
Household Support	15 Years, 10 months	40.7%		
Loss of Consortium	15 Years, 10 months	40.7%		

Generally, the longer the payment period the higher overall return. The anomaly in Long Term Care relates to the application of Collateral Source offset, and the impact of a

significantly higher fee rate applicable to 50B.

Loss of Support and Consortium are treated as any other element of future loss under the provisions of 50B, but as additions to lump sums under 50A.

The system permits the selection in or out of any future loss element. To complete the process, lost or impaired earnings were selected out since their overall returns were high, due to the duration of the payments.

The remaining balance of value was treated as invested in a taxable trust,

- The same payments and payment schedules as in an annuity are applied.
- The average 'AAA' rate is applied against the principal. The current monthly yield is somewhat below that average, but overall the average rate or better should apply
- A fee or load is applied at the front end.
- A trust administration fee of .25% of the opening balance is charged.
- An incremental Tax advice charge of \$400/yr is applied.
- A tax is applied to the gain at 24%.

The net effect is a balance after payments of

- \$84,668 on 50B distributions or 2.2% of payments made
- (\$10,894) on original 50A distributions or 0.2% of payments made. If the planned tax rate of 22.89% were used, the balance would be a positive \$18,207 or 0.4%.
- \$568 on Amended 50A distributions or 0.02% of payments made. If the planned tax rate of 22.89% were used, the balance would be a positive \$14,239 or 0.6%.

None of this takes into consideration that certain Award element payments may be deductible in any itemized return, thus reducing the tax bill.

The trust can also be used to protect additional sums.

- 50A Wrongful Death cases produce the total Award as cash or lump sum. That will place large amounts. The total amount or some portion can be placed in trust to meet the needs of the plaintiff.
- Prior to Amended 50A, lump sums were limited to \$250,000 plus Loss of Services and Consortium under 50A. Amended 50A has the dual effect of reducing the overall Net Award (cash out from the liability carrier) by approximately 26%, while increasing the net lump sum to almost 24% of the overall net Award or almost 27% of the net to plaintiff. This sum can be added to the trust to preserve for the future needs of the plaintiff.

Since no attempt is being made to qualify these trusts under Sec. 130 of the Internal Revenue Code, the trust document can be relatively straightforward. Up to a certain point, the payout from the trust can be scheduled to meet the special, discrete or continuing needs of the plaintiff, that are not by met by any annuities associated with longer term loss elements. In the event that unanticipated needs were to rise, unscheduled withdrawals could be arranged, and with far less cost than the sale of an annuity to meet those needs.

Somewhat interesting, placing shorter term future obligations into trusts could benefit both liability carriers and the annuity companies. Settlement would free the liability carrier of the obligation of guaranteeing these shorter term payments, finding annuity providers for them and, perhaps, providing more than the net element amounts to secure them. Annuity providers may not profit from serving these shorter term obligations.

There is nothing in the statutes that prohibit such arrangements, and, in fact, they may be encouraged. Section 5037 in 50A and Amended 50A, and 5047 in 50B specify

Settlements. Nothing in this article shall be construed to limit the right of a plaintiff, defendant or defendants and any insurer to settle claims as they consider appropriate and in their complete discretion.

The entire process of settlement, before or after verdict, may be facilitated by using our fully valued Award and designating the basis of a fully valued Award that incorporates current

- Taxes on lost or impaired earnings, if appropriate
- Collateral Source Offsets, if applicable
 - ✓ Including past maintenance costs
 - ✓ Including continuing maintenance
 - ✓ Reducing Taxes, if the offset applies against lost or impaired earnings
 - ✓ Reducing the value of the offset for application of expenses and fees.
(The statutes provide that expenses and fees will be applied against individual net elements of future loss, not individual net element values adjusted for offsets. When they are applied, the net result compares closely to sum of the annual discounted values for the future loss element.)
- Discounted by rates indexed to some average 10-Year Treasury rate or yield
- Including interest from determination of liability, if at an earlier point in time, and utilizing second level discounting, as appropriate.
- Direct that shorter term future losses be resolved for cash.
- Set a date for acceptance or further negotiation.