Structured Settlements:
Offering What the Economy Can't

Debunking Four Common Myths

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Debunking Four Common Myths

In a climate of economic uncertainty, people naturally worry about their financial future more so than usual. For those settling personal injury claims, the fear is compounded because the stakes can be so much higher.

To make matters worse, fearmongers with hidden agendas prey upon unnerved plaintiffs by spreading false and misleading information about settlement options under the guise of offering helpful advice.

But is unfounded fear a good enough reason to pass up a structured settlement opportunity?

Probably not. So before rejecting any settlement option, it can be extremely helpful to look backward to see how people fared in other times of economic hardship. History can be a pretty good teacher if you take the time to understand its lessons.

So, for the benefit and peace of mind of clients and the attorneys who represent them, let's address a few of the more common misperceptions circulating about structured settlements today and put them in perspective.

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1 Myth: Structured Settlement Viability Depends Primarily Upon Market Conditions

The underlying premise that structured settlements are "an investment" is false at its core.

Those who view structured settlements exclusively in terms of how other investments may perform may wish to look deeper. Consider the following:

> **Price Isn't Everything** — Few rational people would buy a house built on a toxic dump site simply because it costs less than one in a safe neighborhood with good schools.
>
> **Needs Should Trump Wants** — People generally do not buy a car based solely on its sticker price. An individual wishing to start a towing business, for instance, is unlikely to choose a Smart Car simply because it's less expensive than a Dodge Ram 3500.

Doesn't it make more sense to first analyze one's needs and consider ALL options designed to meet those needs?

In practical terms, many factors should be considered before accepting or rejecting a structured settlement.

Structured settlements have a proven track record of offering safe, secure, tax-advantaged income for those who need it when they need it. The Dow Jones Industrial Average cannot make such a claim.

Better: Ask yourself/your client these questions:

- What will you need the money for?
- When will you need it?

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The family of a ventilator-dependent quadriplegic is going to care far less about the overall economy than they are about the ability of settlement proceeds to provide long-term security for their loved one.

A widower whose wage-earning spouse was killed by a drunk driver will likely be more concerned about meeting the day-to-day financial obligations of his family than he will hoping to eke out a few extra dollars in stock returns.

REALITY CHECK: Structured settlements transcend market conditions because, as a needs-based option, they eliminate financial guesswork.

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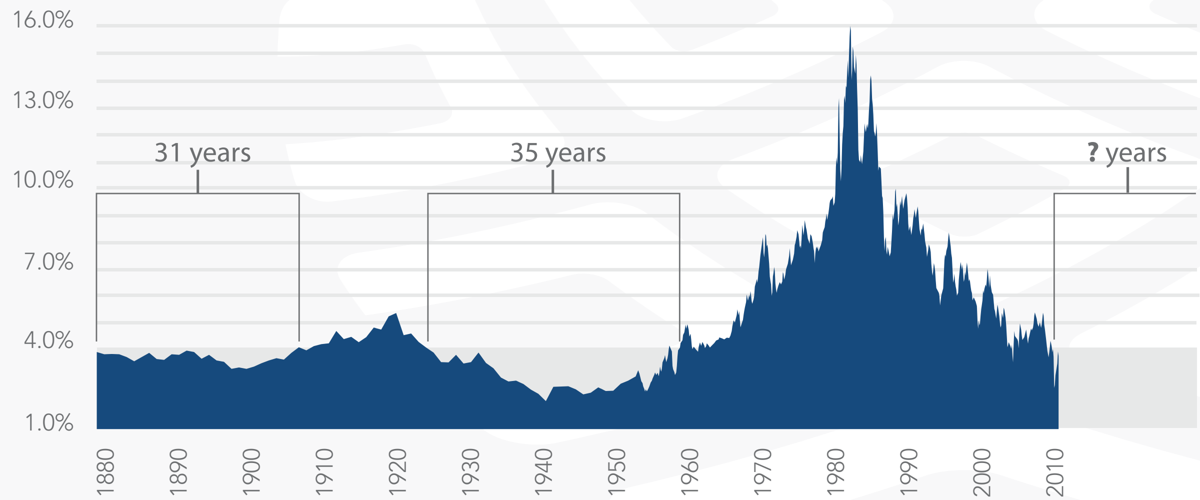
2 Myth: Interest Rates Are at Historic Lows So It's a Mistake to Structure

When Matt Damon's character in *Good Will Hunting* solved the "unsolvable" algebraic graph theory problem written on the chalkboard of the MIT classroom where he worked as a janitor, he didn't know it was unsolvable. True, the character was a mathematical genius but it's also true he was unhampered by the self-imposed limitations that came from knowledge that the solution to the problem was "impossible."

Similarly, people who base their assumptions about interest rates on their own recent memory are going to limit their ability to properly evaluate any settlement option. Yes, long-term rates are lower than most of us in the workplace can ever remember. But what happens if we take a longer view? What if we compare today's rates to those surrounding some of the other major financial melt-downs of prior centuries? Specifically,

- The Financial Panic of 1873, and
- The Great Depression



Source: *Irrational Exuberance*, Princeton, 2005

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According to data extrapolated from *Irrational Exuberance* (Princeton, 2005) interest rates typically dropped before, during and following major cataclysmic events such as those mentioned. But how long did rates remain "depressed?"

Three times in our nation's history have long-term interest rates fallen below 4% and remained there for longer than a year. 1880, 1924 and 2008. While it's too soon to know with any degree of certainty how long rates will remain "low" this time around, most people are shocked to learn that the last two times this happened, rates stayed below 4% for more than 30 years!

Certainly rates might rise but anyone who denies the possibility that we might need to adjust to living with the current interest rate environment for quite awhile may be relying too heavily on short-term experience.

REALITY CHECK: Structure settlements provide long-term guaranteed income that offers a major tax advantage and will remain popular regardless of interest rate cycles.

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3 Myth: Inflation Will Lower the Value of Future Structured Settlement Payments

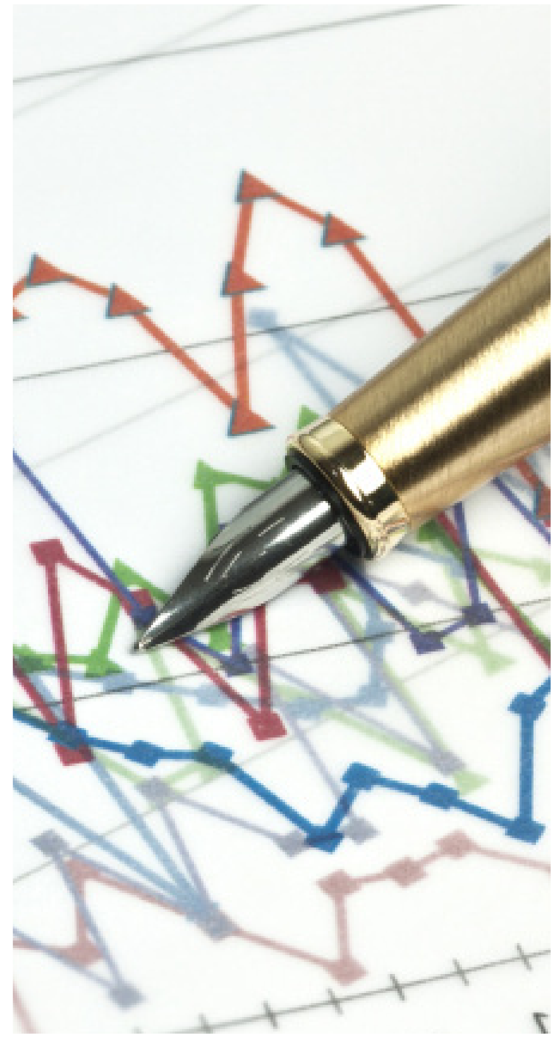
At the risk of downplaying the importance of this concern: Isn't this true of all financial products? Of course inflation will impact structured settlement payments. Just as it will affect retirement savings and everything else with a dollar sign attached to it.

But since most structured settlement recipients use their benefits to provide secure steady cash flow, they can't afford the luxury of setting aside funds in some speculative investment hoping to outsmart the inflation boogeyman. (Reminder: stocks are investments which can lose value as easily as they can gain value)

So what about inflation? What does history teach us about this ominous presence?

A review of annual historical data compiled by the Bureau of Labor Statistics reveals that, since 1914, inflation has been above 4% in only thirty-one of those years. And almost half of that took place during the stagflation years of the 70s — early 80s. That means 67% of the time, inflation has been below 4%. Knock out the oil embargo years and it's been manageable more than 75% of the time.

SURPRISE: In the decade following the Great Depression, inflation only rose above 3% twice and was negative for six out of those ten years!



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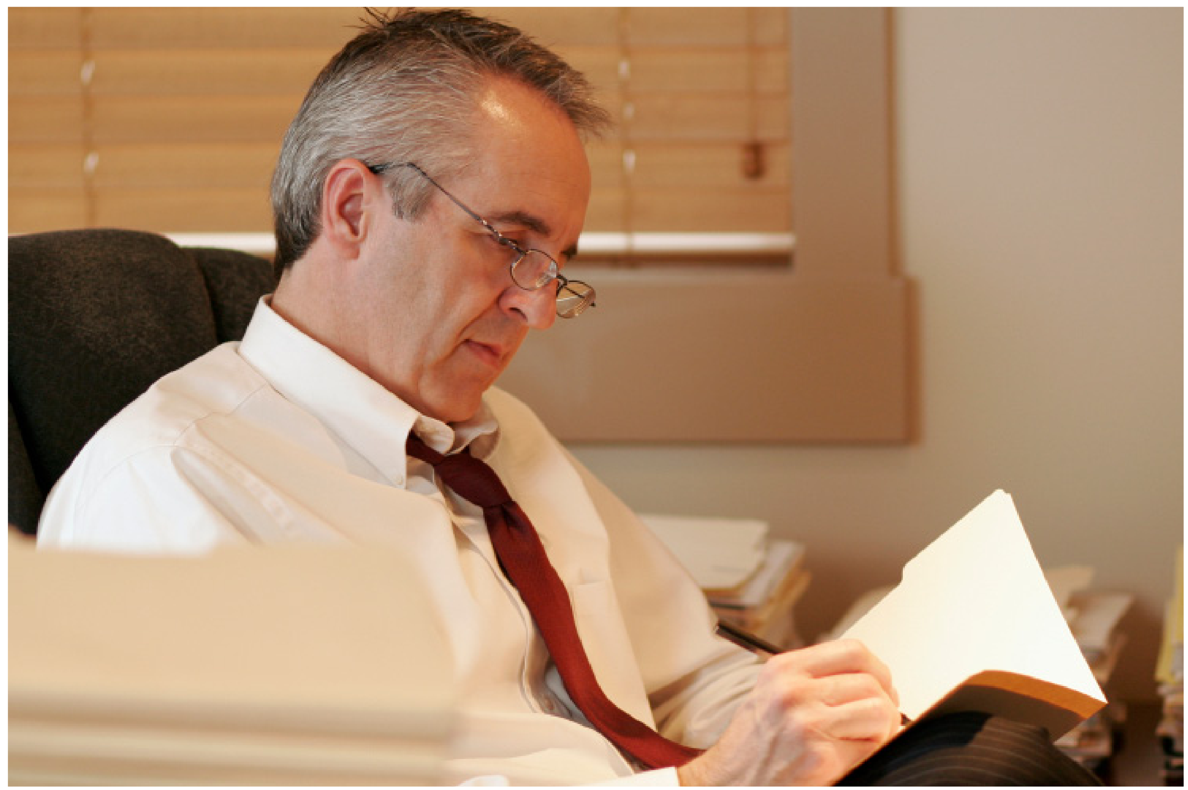
For plaintiff attorneys who structure their fees, a recent article in Kiplinger's Retirement Report offers an encouraging perspective. In its article "A Ladder of Annuities Can Hedge Your Bets" (November, 2009, p. 6) the authors suggest "laddering" annuity purchases (i.e. Buying annuities over a period of time as opposed buying all at once) to achieve an optimum balance of retirement security and hedge against inflation. They point to a 25-year MassMutual study that compared and contrasted several retirement-income strategies only to discover the portfolio with laddered annuities returned 67% more money than the traditional stock/bond portfolio and provided the highest return of all portfolios studied.

REALITY CHECK: Structured settlements can actually serve as a hedge against inflation by designing plans that anticipate increased costs.



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4 Myth: Over Time, The Stock Market Will Always Outperform Structured Settlements

The secret to good comedy is timing. But there's nothing funny about the anxiety most all of us felt when bad timing caused the balances of our 401(k) plans to nosedive.

Like many people, I followed the conventional wisdom of investing in balanced mutual funds for my 401(k) contributions for many years. Unfortunately, annuity purchases weren't one of the options my company's 401(k) plan administrator offered. Notwithstanding, I enjoyed watching the value of my retirement fund grow seemingly by the hour and kept stashing away as much as I could year after year. I was dollar-cost averaging and was secure (or thought I was) in the knowledge that my nest egg would continue to grow exponentially with only periodic blips along the way.

But then the BIG bottom fell out!

My account dropped to less than half its value. And it did so in a hurry! More than two years and 200 or so bottles of Pepto-Bismol later, the balance has gained back a good portion of what it gave up but the anxiety brought on by this financial chaos was, and still is, difficult to endure.

For years I compared mutual fund "10-Year Averages" in excess of 10% and made seemingly wise choices accordingly. A review of my 401(k) balance recently revealed my average performance for the past ten years to be less than 2% thanks mostly to 2008/2009. (2010 and 2011 have, until August, fared far better) I suppose

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this means my 20 year average is somewhere between the two. Still not bad. Little comfort, though, when I read my statement these days. But at this point I'm just thankful Bernie Madoff wasn't my advisor. Meanwhile, pass the Pepto-Bismol please.

GRIM REMINDER: A portfolio loss of 50% requires a gain of 100% just to break even!

Finally, the most overlooked fallacy of comparing stock fund returns to those of annuities is this: Stock return averages typically assume a buy-and-hold strategy whereas annuities provide cash flow. They really are apples and oranges. Stocks can offer terrific wealth accumulation potential. But they can also lead to untold misery. Fixed annuity returns are commensurate with their risk. With lower risk one naturally expects lower returns. But as any fan of Aesop knows, the tortoise crosses the finish line first in the end.

REALITY CHECK: With a decided tax advantage, structured settlements compare favorably to long-term stock market averages. Minus the anxiety.

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Summary

Structured settlements remain a solidly viable settlement alternative in good times and, some would argue, especially in bad times. Those seeking safe, secure, tax-advantaged cash flows should consider this proven alternative and reject any fear-based propaganda.

Plaintiff attorneys and their clients have many options available to them when choosing how to arrange their post-settlement financial affairs. Careful evaluation of a person's risk tolerance and goals will usually lead to the right decision. For many, a structured settlement will be a sensible part of their solution.

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About the Author

Dan Finn is President of Finn Financial Group, LLC — A Newport Beach (CA) based specialty planning firm offering Structured Settlements and related products and services for clients nationwide. A former teacher, he also offers customized training seminars to clients seeking expertise in this area. FinnFinancialGroup.com

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