

# Top 10 things to remember when creating a structured settlement

By Patrick Farber

Details are important when it comes to structured settlements. So is timing. Counting down, here is the top 10 list of things to remember when creating a structure – for your client or for your legal fees.

## 10) When settling a case at mediation, let the defense know of your structuring intentions

There are many issues to consider at the close of a mediation, especially if a settlement has been reached. If you or your client is thinking about structuring a portion of the settlement, this is the time to get it in writing in the mediator-provided signed agreement.

No one like surprises when it comes to concluding a settlement. If the defense has not been notified of your plans to structure, you may encounter some resistance later on. Since the defense's cooperation is necessary for the implementation of release documents, the qualified assignment and check issuance, communicate your position. Make sure the mediator includes a

sentence in the documents stating that you or your client may wish to structure a portion of the settlement and that all parties agree to cooperate if you decide to exercise that option.

## 9) Give your broker the correct birth date for your client

This sounds easy enough, but surprisingly, mistakes occur. An incorrect birthdate can create havoc especially in the case of a minor child. Suppose you are representing two minor children and you tell your settlement broker that they are age 4 and 6 instead of providing their actual birthdates. Their parents agree to annuity payouts to the minors at ages 18 to 22 to pay for the children's college education. The Minor's Compromise is approved. It turns out, however, the children were actually 6 and 8 at the time of the settlement. Now, the payments at ages 18 through 22 will be noticeably less than expected because the life company has a shorter period of time to invest the annuity premium.

In this example, the cost of an annuity so a 6-year-old child could receive \$50,000 at ages 18 through 22 is \$156,000. If the minor is actually age 8, the cost of providing \$50,000 at ages 18 through 22 increases to \$175,000.

Always take the time to verify birthdates and relay those dates to your broker when requesting proposals.

## 8) Request that your broker lock in annuity rates

Interest rates are constantly changing, for better or for worse. Once you have decided on a payment plan, request that

your settlement broker immediately lock in the rate and benefits for your client. Most printed quotes are guaranteed for only seven days. After that, the quote must be updated based on any changing market conditions.

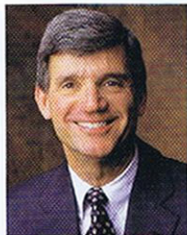
For example, if you settle your case in June but the Minor's Compromise hearing is not until August, share that information with your broker so the rate and benefits will still be valid by the time the court hearing takes place. If you fail to do so and the rate expires, rates and correlating benefits will most likely have changed. This will require another court date to approve the corrected benefits, which may now be less.

Other issues can drag out the timeline between a settlement and final agreement. Approving releases, checking lien amounts, receiving court approval of trust documents and ensuring that defendants have enough time to fund the settlement can take longer than expected. To be safe, it is best to secure the agreed-to benefits for at least several months.

## 7) Be sure a Medicare Set Aside is done right

If you decide to use a Medicare Set Aside (MSA) be sure the company developing the MSA does an allocation based on an annuity and not just a cash deposit. The use of the annuity can lower the overall cost of the MSA leaving more settlement funds available for other client needs.

Here's an MSA example for a 50-year-old female: Once the MSA company has reviewed the necessary medical records, it may suggest a cash cost allocation of \$250,000. If you request an annuity cost allocation instead, the MSA company



Patrick C. Farber is a structured settlements broker in California with Atlas Settlement Group. He specializes in settling medical malpractice, physical injury, non-physical injury, product liability, workers' compensation, mass torts,

punitive damages, employment and elder abuse cases with structured settlements in court hearings, arbitrations and settlement conferences. 800-734-3910, pat@patfarber.com

may suggest a cash deposit to the MSA account of \$30,000 with a lifetime payment of \$9,000 per year for life that costs \$170,000. The total MSA cost would be \$200,000.

The savings to your client is \$50,000 – the difference between the cash cost allocation (\$250,000) and the annuity cost allocation (\$200,000).

**6) Attach an addendum to the Minor's Compromise that indicates whether annuity payments go to the minor or to a Special Needs Trust (SNT)**

If not spelled out, the court may approve payments directly to a blocked account when payments to a SNT would provide a better outcome. To ensure that the court correctly dictates where the funds will go, you should include payment instructions in an addendum to the Minor's Compromise.

An annuity carrier can only make payments to an individual or trust approved by the court as defined in the settlement agreement. If the court approves payments to an individual when payments were meant to go to a trust (or vice versa), the life carrier will need a corrected order to legally change the name of the payment recipient.

**5) Have your broker (not you) explain annuity proposals to your client**

The structured settlement and its many options should be explained by your broker to your client. The broker should be with you when discussing settlement options with your client. He or she can fully explain the many facets of a structured settlement.

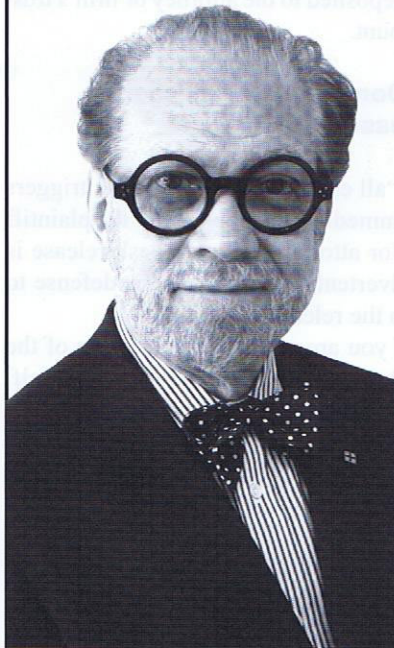
If your client decides that an annuity is not a good fit and takes a cash settlement instead, ask your broker to document their meeting and decision in a letter for your file. That way, if the client comes back and claims he or she was never told about the structuring option, you will have the documentation proving otherwise.

**4) If you plan to use an SNT with the settlement, your trust expert must alert your broker**

Stringent rules apply when it comes to SNTs. Most importantly, if the client



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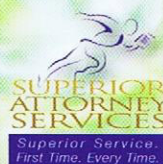
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qualifies for an SNT, money from a settlement annuity has to be paid to the SNT not to the individual. This is critical. If money goes directly to a client in these cases instead of into an SNT, the client may have to forfeit government assistance such as MediCal (Medicaid) and SSI.

Your broker will need the correct name of the trust so that the annuity payments from the life insurance carrier are made directly to the trust and not to the individual.

### 3) Alert the defendant and your broker if you are structuring a portion of your fee

If you decide to structure a portion of your fee, specific language and instructions must be included in the settlement agreement and release so you receive the tax deferral benefit. A separate check from the defendant is then made out to the annuity company for deferred attorney fees.

For example, if the attorney fee is \$200,000 and the attorney wishes to have

\$50,000 placed into an annuity, the defendant makes out the check to the life insurance company issuing the annuity. The balance of the fee, \$150,000, would be deposited to the attorney or firm's trust account.

### 2) Don't sign an "all cash" release

An "all cash" settlement release triggers an immediate tax liability for the plaintiff and/or attorney. If an all cash release is inadvertently signed, ask the defense to redo the release immediately.

If you are structuring a portion of the settlement for your client or yourself, your broker must provide you or the defense with the mandatory structured agreement and release verbiage that states all of the annuity payments to your client be tax-free or, in the case of fees, tax deferred. The life company will not be able to make the annuity payments without the settlement language included and the release signed by all parties.

And the number one point to remember:

### 1) Never put your client's settlement or the fees you want structured into your firm's trust account

The previous nine "things to remember," in most cases, can be rectified if caught early enough. This last point, however, cannot. If your client's settlement amount or your legal fees are deposited into your firm's trust account, they automatically belong to you and your client.

In order for an annuity in a physical injury case to provide tax-free benefits to your client and for legal fees to accumulate on a tax-deferred basis, the settlement amount has to be purchased in the form of an annuity by the defendant through your broker from the life company. Once you take possession of the funds in your firm's trust account, you are viewed as taking ownership of the funds. Your client would still receive these funds tax-free, however, anything they do with the funds afterward (make investments, purchase their own annuity) becomes a taxable event. Your fees would be taxed in the year the fees were received instead of growing tax-deferred. ■



Traci Kaas, CSSC  
Managing Partner  
Settlement Planner

Certified Financial Transitionist™  
traci@alliance-west.com



Tanis Kelly, Esq.  
Settlement Planner  
tanis@alliance-west.com

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