Evaluate, Negotiate, Settle: Putting Structured Settlements to Work

Beyond the benefits they offer to claimants, structured settlements can be of great value to insurers in evaluating, negotiating and settling claims. By utilizing structured settlements to their full potential early in the process, insurers can resolve claims, and in particular catastrophic claims, more quickly and cost-effectively than would otherwise be possible.

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What is a Structured Settlement?

Put simply, a structured settlement is an alternative to the traditional single, lump-sum payment of damages in cases involving personal injuries or death whereby a claimant receives a series of periodic or annuity payments over time (either for life, or for a fixed term).

Structured settlements were introduced in the 1950s to prevent early exhaustion of personal injury awards and gained widespread popularity in Canada in the 1980s when the government afforded them tax-free status.

Where a structured settlement is utilized, a lump-sum of damages is used as a premium to purchase an annuity issued by one of the three life companies presently underwriting structured settlements in Canada. The terms of the structure are subject to considerable flexibility at inception to allow claimants to design a plan which best responds to their personal circumstances. Payments can be fixed or indexed to keep pace with inflation and lump sum payments can be incorporated to provide for known or anticipated future expenses. How and when the payments are received is flexible and can be monthly, annually or at other pre-determined intervals. Payments can last for a specified period of time or for life. Most importantly, all payments received by the claimant, including the interest earned on the lump sum investment, are tax-free.

Evaluate

Although structured settlements are often associated with the final stages of settling and closing a claim, the best time to initiate contact with a structure broker is early on in the claims process, starting with an evaluative report.

Evaluative Reports

Evaluative reports, using real market rates, are available for free from structure brokers and provide insurers with a starting point for evaluating claims and setting reserves for first party claims. An evaluative report quantifies what a claim is

worth today using structured settlement quotations, taking into account what coverages are available, the remaining limits and the relevant medical evidence.

Relatively little information is needed in order to prepare an evaluative report aside from the claimant's name, sex, date of birth, date of loss, and any paid to date amounts for medical/rehabilitation and attendant care benefits. Multiple options can be costed for each of the available benefits, giving insurers the ability to consider different scenarios depending on how the claim progresses.

Impairment Ratings

Evaluative reports also typically incorporate reduced life expectancy as a result of the impairment ratings received from the life companies. An impairment rating is an acknowledgment by a life company that, based on medical documentation, a person may have a life expectancy that is shorter than normal for a person of the equivalent age and sex. For example, the standard life expectancy for a 25-year-old female is currently 59.7 years, meaning that she is expected to live to 84.7 years of age. If that same female has an impairment rating of +5, it means that the life company views her as the equivalent of a 30-year-old female due to her impairments, with a reduced life expectancy of 54.8 years.

Impairment ratings increase the income on a life annuity or, conversely, reduce the cost required to provide specific lifetime payments (such as for income replacement benefits, housekeeping, attendant care and medical and rehabilitation benefits) as they are based on the assumption that the claimant will die (and thus payments will stop) earlier than is typical. As a result of impairment ratings, structure rates, which are based on real market rates, are typically lower than actuarial present values.

In terms of timing, the life companies' preference is to not rate until after the one-year anniversary of the date of loss, so as to allow some time to pass to see which impairments, if any, have resolved or improved, and which have not.

Impairment ratings are valid for a period of two years, after which time they must be renewed. Where a claimant's health has worsened over time, updated impairment ratings should be sought.

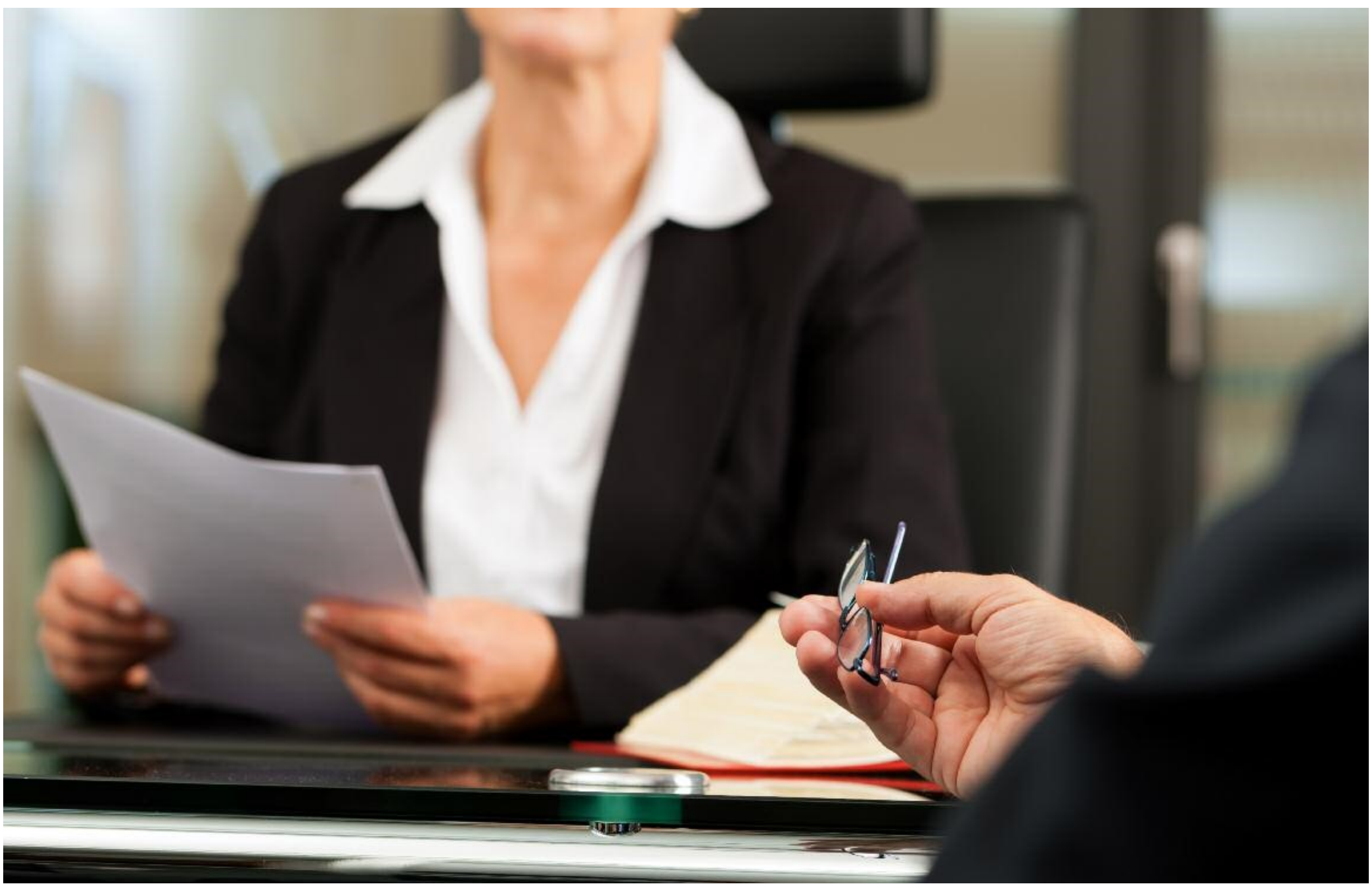
In order to obtain the most accurate impairment ratings, it is best to provide the life companies with one to three recent medical reports dated within the last two years that adequately summarize the claimant's available medical documentation, accident history and impairments, both accident-related and pre-existing.

As it is in the parties' interest to obtain the highest possible impairment ratings so as to increase income and reduce structure costs, care should be taken when selecting the documentation to be submitted.

For insurers, this may mean submitting reports obtained by the claimant or their lawyer. For claimants with a documented history of pre-and/or post-accident mental health issues, psychological or other reports detailing same should be included as this can have a significant impact on impairment ratings.

Involving a Structured Settlement Consultant at an Early Stage

Involving a structured settlement consultant in the file at an early stage allows the consultant to become familiar with the details of the claim and to guide the insurer in obtaining meaningful impairment ratings. As the parameters of a claim can change with time depending on how the claimant responds to treatment and the severity of their injuries, and in light of the fact that structure rates fluctuate daily, a structure consultant can provide the insurer with updated evaluative reports on an ongoing basis for the purposes of adjusting



reserves or considering settlement.

On files where there is a possibility that a structure will be required (such as where the claimant lacks capacity or is a minor), or strongly recommended as part of a settlement, the early involvement of a structure consultant also allows for the concept to be introduced to the claimant (and their counsel, if any) well in advance of any negotiations. By laying the appropriate groundwork early in the process, it is less likely that the well-intentioned suggestion by an insurer regarding the use of a structured settlement during negotiations will be met with pushback on the part of the claimant.

Negotiate

A structured settlement is a valuable and effective negotiating tool for insurers, especially when attempting to settle claims, and in particular, first party claims.

Mitigating the Risks Associated with Settling First Party Claims

Unlike with a tort claim, there is nothing obliging an insurer to cash-out a first party claim. Rather, the insurer can simply continue to pay the claimant on an incurred/ongoing basis, as per the terms of the contract, while earning interest on its reserves. In the event the claimant dies prematurely, the claim is closed and the reserve released to the company.

It is no surprise then that when faced with large claims, such as those where the claimant has been deemed catastrophically impaired or is arguing in favour of a finding of catastrophic impairment, an insurer may be hesitant to settle out the claim. This hesitancy can arise due to the risk of the claimant dying prematurely after a large pay-

out has been made and also because of concerns that the claimant, to whom the insurer owes a duty of good faith, may not have sufficient funds and/or other resources (e.g. cognitive skills, etc.)

to manage their long-term care needs on their own.

A structured settlement addresses both of these concerns, allowing the insurer to confidently close its file.

To hedge against the possibility of a premature death, a reversionary interest can be added to the structure, wherein the commuted value of the structure reverts back and is paid out to the insurer if the claimant dies during a defined period.

For example, if a claimant has a structure with a 10-year reversionary interest, and the claimant dies at the end of year six, the insurer would receive back the commuted value of years 7 to 10 of the structure.

A structure also provides the insurer with certainty that the investment principal is protected and that the claimant will receive funds regularly on a long-term basis to provide for their future care needs. Once placed, the terms of the structure are fixed, and the structure is non-assignable (neither the policy nor any proceeds therefrom are capable of being assigned by the owner or the annuitant, collaterally or otherwise); non-commutable (the structure cannot be collapsed for its present-value, lump-sum equivalent) and non-transferable (neither the policy nor the proceeds may be transferred by the owner or the annuitant, collaterally or otherwise) by the claimant.

Structured Settlements as a Negotiating Tool

As the availability of a structured

settlement rests with the insurer and cannot be obtained without the insurer's consent, a structure can be a useful bargaining tool for the insurer while negotiating a settlement.

The ways a structured settlement can be utilized are varied. For example, a claimant may take a discount on the settlement amount in exchange for an insurer agreeing to forego a reversionary interest, thus allowing the claimant to add a guarantee to the structure. A guarantee allows a claimant to name a secondary payee to receive any remaining guaranteed payments tax-free in the event of the claimant's death during the term of the structure and can be an appealing option for many claimants and especially those with dependants.

Having a Structured Settlement Consultant Available During Negotiations

By having an independent and neutral structured settlement consultant available at mediation, settlement meetings and pre-trials, insurers and claimants have access to real time calculations as the negotiations progress. This allows both parties to make well-informed decisions, and in particular allows claimants to visualize the income (monthly or otherwise) that can be generated from a settlement and evaluate it in relation to their ongoing needs. By seeing a monthly (or other) amount, claimants get a better sense of how the settlement would complement their overall financial picture in more concrete terms than are otherwise available when considering a lump sum pay-

ment and because structure payments are tax-free, the amounts the claimants see are what they get, without any further calculations required.

A structure consultant can also show claimants how a smaller total dollar figure can be structured in a way to maximize their returns to ensure they can provide for any ongoing necessities.

For claimants who receive government benefits such as Old Age Security, Guaranteed Income Supplement, Ontario Disability Support Payments, and Canada Child Benefit, among others, the ability of a structure to preserve entitlement to these benefits is likely to be of critical importance to the claimant and can be explained in real time as decisions are happening.

Settle

It can often be difficult to get a claim past the negotiating stage and secure a settlement. Parties frequently become entrenched in their positions and the gap between the two sides becomes harder and harder to bridge. Perhaps one of the most important aspects of structures, from the perspective of both insurers and claimants, is that they can encourage settlement but bridging divides between the parties.

Using a Structured Settlement to Bridge Divides

As structure payments are completely tax exempt, structures create a win/win situation, whereby