McKellar STRUCTURED SETTLEMENTS

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PROFESSIONAL PERSPECTIVES

STRUCTURED SETTLEMENTS AND LIFE ANNUITIES

Most structured settlements are designed to provide lifetime payments to the Plaintiff. These structures give the Plaintiff and his family the security of knowing that the payments must continue for as long as he lives, no matter how long that may be.

In addition, structures are almost always designed to include a guarantee, for example: lifetime payments guaranteed 25 years.

The guarantee means that the payments must continue to the end of the 25-year guarantee period, even if the Plaintiff dies within 25 years of the start date. In that case, the remaining guaranteed payments would be paid to the Plaintiff's estate. Of course, if the Plaintiff lives beyond 25 years, they will continue for as long as he lives.

These structured settlements are funded using life annuities. The Defense agrees to provide the Plaintiff with lifetime payments, supported by the purchase of a life annuity from a major life insurance company to ensure that the Plaintiff receives the payments.

Choosing a structure with lifetime payments guarantees that a Plaintiff **will not outlive his settlement**. On the other hand, with a lump-sum settlement, (which is always based upon some **assumption** as to life expectancy), it is virtually certain that the Plaintiff will live either longer or shorter than the assumed period of time. Consider a Plaintiff who chooses to invest the lump-sum settlement funds himself. Even if he succeeds in earning the investment returns and in spending the money exactly as planned in the settlement, there is a very great chance that he will live longer than the settlement anticipated and run out of money. For a Plaintiff with serious injuries, that is a disaster which must be avoided.

With a structure providing lifetime payments, the life insurance company takes on the risk that the Plaintiff may live longer than expected. Since life companies issue thousands of annuities, they can afford to rely upon average life expectancies. An individual Plaintiff cannot. Fortunately, with a structured settlement, he does not have to.

THE ONE CONSTANT ABOUT LIFE EXPECTANCIES OVER THE PAST CENTURY IS THAT THEY KEEP GETTING LONGER.

	1930	1970	1990	2010	2030
Female life expectancy at birth (in years)	62.06	76.45	80.89	83.60	?
Male life expectancy at birth (in years)	60.00	69.40	74.55	79.33	?

Source: Statistics Canada

INCREASING PAYMENTS THROUGH THE USE OF IMPAIRMENT RATINGS… AT NO COST OR RISK

The payments that can be created from a lifetime structured settlement depend on the age and sex of the Plaintiff, which determine how long that Plaintiff is expected to live.

For example, it costs far more to provide payments of $1,000.00 per month for life for a 10 year old girl, than for a 70 year old man. Quite simply, this is because the life insurance company expects that it will have to pay the 10 year old many more payments over the much longer period that she is expected to live.

"Impairment ratings" reflect the fact that a 10 year old girl who is a quadriplegic will probably not live as long as a healthy 10 year old. There are all sorts of different injuries and health problems which can have an impact on life expectancy. Indeed, in many cases where the Plaintiff's doctor believes that she has a normal life expectancy, the life companies may still be willing to treat the Plaintiff as having a shortened life expectancy on account of her injuries.

Even if the Plaintiff's health problems have nothing to do with the accident, for example diabetes or heart disease, they will be taken into account by the life companies and will work to her financial benefit.

For the majority of structured settlements, we are able to obtain an impairment rating for the Plaintiff which allows us to increase the payments that a lifetime structure will generate. The nice thing is that this increase is obtained at no cost or risk to the Plaintiff whatsoever. The life insurance company must still pay her for as long as she lives, or for the length of any guarantee period, but the payments are higher as a result of the impairment rating.

In most cases, we obtain medical reports from the Plaintiff's lawyer, and forward them to all of the major life insurance companies. Of course, this is done on an entirely confidential basis. The doctors and medical underwriters at the life insurers review the information about the health of the Plaintiff and translate it into an impairment rating. Also known as a "rate-up", it is used by the life insurance company to artificially age the Plaintiff for the purposes of life annuity quotations. For example, if a 50 year old woman has been rated +15, then for the purposes of arranging a life annuity for her benefit, the life companies will provide quotes based upon an artificial, assumed age of 65 years.

Some people mistakenly believe that the rate-up of +15 is simply subtracted from normal life expectancy. The 50 year old woman in this example has, according to Statistics Canada, a remaining life expectancy of 35.12 years. If the rate-up was subtracted, that would imply a remaining life expectancy of 20.12 years. In fact, since the life insurers will artificially age her by 15 years, she is actually treated as if she were a 65 year old woman and has, according to Statistics Canada, a remaining life expectancy of 21.73 years.

As the Plaintiff ages, she outlives a number of risks (illnesses and accidents) along the way, and, as a result, the longer she lives, the longer her total life expectancy (or to put it another way, the greater the age she will be expected to live to). The woman in our example is simply treated by the life company as if she has attained age 65 and has the life expectancy of a normal 65 year old.

From the Plaintiff's viewpoint, the key is that impairment ratings help structured settlements to generate higher lifetime payments, without any cost or risk to her at all. No other investment offers this advantage.

EXAMPLES OF THE BENEFITS OF IMPAIRMENT RATINGS

Example 1: John Doe, a male born on January 1, 1977, has settled his personal injury case for $400,000.00. He has decided that he needs a lifetime structured settlement, with payments indexed at 2% per annum, compounded, with a 20 year guarantee period to protect his children. The starting monthly payments which can be generated with no rate-up (standard mortality) and with rate-ups of +15 and +30 are set out below:

Rate-up 1	No rate-up (normal mortality)	+15	+30
Monthly Payment	$762.02	$1,096.30	$1,586.57

Please bear in mind that all three structures are identical. They must pay for as long as John Doe lives, or up to the end of the 20 year guarantee, to his children, in the event that he dies prematurely. The rate-ups simply allow us to significantly enhance the payments which he will receive.

Example 2: Jane Doe, a female born January 1, 2002, suffered a very serious brain injury and will never be able to function independently. Her case was settled for $2,000,000.00. She requires lifetime payments indexed at 2.5% per annum, compounded. As she has no dependents, a guarantee is less critical. Still we have incorporated a 15 year guarantee to provide substantial estate protection for her parents. The table below shows the payments that we could generate based upon no rate-up (standard mortality) and with rate-ups of +40 and +55. Once again, all three structures are identical, except for the increased payments on account of the rate-ups.

Rate-up 2	No rate-up (normal mortality)	+40	+55
Monthly Payment	$2,058.96	$4,764.89	$7,876.27

* Based on structured settlement annuity rates in effect on March 17, 2016.

USING GUARANTEE PERIODS TO PROTECT DEPENDENTS

Sometimes a Plaintiff is concerned that, if she chooses a structured settlement based on a life annuity, the payments will simply cease upon her death.

She worries that after her death, all of the money that was paid to the life company to fund the structure will be gone. In fact, almost all structures based upon life annuities incorporate a guarantee period. A guarantee period ensures that if the Plaintiff dies prematurely, her estate (generally family members), will receive all of the payments up to the end of the guarantee. After her death, the payments simply continue to her estate. Importantly, the payments **also flow to the estate on a completely tax-free basis**.

A guarantee is an excellent way to provide for dependents. For example, if the Plaintiff has a five year old child, she should consider a guarantee of at least 20 years, to ensure that should she die prematurely, the payments will continue to be available to her child, until the child is grown up and independent.

Generally speaking, guarantee periods are a very cost effective way to provide protection for the Plaintiff's family. As a result of her injuries, the Plaintiff will often find that she is unable to obtain life insurance at all, or without paying very high premiums. For this Plaintiff, the availability of a guarantee is a vital safeguard for her dependents.