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Retirement Weekly

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August 5, 2011 (Vol. 9, No. 31)

In search of higher yields?

Proceed with caution when considering "factored" or "in-force" structured settlements

By Gail Liberman and Alan Lavine

In a day and age when the stock market is a risky as could be, and CDs and short-term bonds aren't paying all that much, you might find yourself searching for something that provides a higher yield and—at least on paper—some safety of principal.

And that search might lead you to something called a "factored" or "in-force" structured settlement transactions.

"Factored" or "in-force" transactions can earn you a 6% to 6.25% rate with fixed payments for 20 years, guaranteed by an "A" rated insurance company, according to Patriot Settlement Resources LLC, a Boca Raton, Fla. factoring company.

By comparison, the average yield on U.S. investment-grade corporate bonds fell this week to an all -time low of 3.51%, according to Bank of America Merrill Lynch. The previous low, 3.53%, was on Nov. 4. And the 10-year U. S. Treasury note was trading at around 2.5%.

But these structured settlement transactions – remember that old saw about the greater the potential return, the greater the risk – also come with plenty of potential problems.

For instance, if the insurance company goes belly-up, state insurance guaranty funds typically cover annuities to just $250,000.

And so the question at hand is this: Should you consider investing in a high-yielding "factored" or "in-force" structured settlement transaction?

Experts advise that you weigh offers of these investments, usually sold by specialty finance or "factoring" companies subject to little or no government regulation, very carefully.

Also, they suggest that you learn the differences between structured settlements and "factored" or "in-force" structured settlements.

Structured settlements are arrangements generally made in conjunction with lawsuits or via court orders. Instead of getting a settlement upfront in cash, an injury victim, for example, may opt to have the defendant, often through a life insurance company annuity, arrange for payments periodically for a specific term or for life. Encouraged by the U.S. Congress in 1982, structured settlement arrangements are attractive in cases involving disabilities, guardianship,

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workers comp, wrongful death and severe injury. They can help insure that the victim can meet future medical expenses and basic living needs. Similar structured settlement arrangements also are common for lottery winnings.

Sweetening the case for carefully arranged structured settlements: Payments, at least in personal physical injury, wrongful death and workers comp cases, often are both state and federal income tax-free. With annuities, by contrast, at least the earnings portion of periodic payments you receive usually are taxable.

"Factored" or "in-force" structured settlements, though, reflect the secondary market for structured settlement transactions. A secondary market can add risks and costs to an investment due to added intermediaries involved.

With a factored structured settlement, a personal injury victim needing cash to pay bills, for example, may sell his or her payment stream to a factoring company at a deep discount in exchange for a lump sum.

The factoring company and any other intermediaries in the transaction, such as insurance agents or financial advisers, can take cuts before an investor gets payments from the insurance company.

The largest player in the secondary market for factored structured settlements is believed to be J.G. Wentworth in Radnor, Pa.

Since the credit crunch started in 2008, this secondary market has gravitated from institutional investors like banks and financial institutions to private investors, observes Peter Vodola, a partner in the West Hartford, Conn., law firm of Seiger Gfeller Laurie LLP.

But beware if you're considering investing in a "factored" or "in-force" structured settlement. At this writing, 47 states — excluding only Wisconsin, Vermont and New Hampshire — require that secondary market structured settlement transactions obtain court approval, Vodola says.

Terms of those state Structured Settlement Protection Acts, designed to protect injured victims from being coerced into unfavorable sales terms and bad financial decisions, vary. Any factoring company that fails to comply with state Structured Settlement Protection Acts also may face a steep IRS-levied excise tax.

Only two states require that factoring companies facilitating structured settlements be registered, Vodola says. The Maine Bureau of Insurance requires "structured settlement transferees" to register. And the West Virginia Secretary of State's office requires "purchasers of future payments," to register.

Sean McManus is a sales manager of Patriot Settlement Resources LLC, one of 15 listed members of the National Association of Settlement Purchasers, Addison, Texas. That's the trade association for the structured settlement secondary market.

His company, which unlike several other factoring companies showed no complaints with the Better Business Bureau at this writing, keeps an in-house legal department. The company purchases the payment stream from lawsuit victims and sells the payments to investors, netting some $3,000 in the transaction before investors receive their payments.

His company arranges to have the transaction court-approved and "assigned," so

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that an investor receives payments directly from the insurance company. Only about three times in the company's eight-year history, McManus says, has a court rejected a deal. For those rejections, he largely blames clients who, upon going to court to get their lump sums, changed reasons for needing the cash. In those cases, he says, his company -— not the investor -- ate the loss.

Now, "the problem is we're seeing more people trying to do these deals and courthouses are laying off staff," McManus says.

However, not all deals operate the same way. Sometimes, companies, for example, may "service" or handle the insurance company payments to investors. Others may independently broker to other companies.

Before investing in factored structured settlements, get legal and accounting help in investigating these deals. Check the factoring company for complaints. Do business directly with top-rated insurance companies.

The highest-rated insurance companies are rated A++ and A+ by A.M. Best. Evaluate with an accountant or tax attorney whether a structured settlement's tax-free benefits apply to your investment. Make sure you're comfortable with this investment's lack of liquidity.

Even if a court approves your deal, Vodola warns, this relatively new type of investment still could face unanticipated future legal challenges. **RW**

About the authors: Gail Liberman and Alan Lavine are personal finance columnists and authors of "Rags To Retirement (iUniverse Inc.)."

Analyzing the debt-ceiling law

President Barack Obama this week signed the so called debt-ceiling bill into law. The new law, the Budget Control Act of 2011 (Sen. 365 as amended), raises the nation's $14.3 trillion debt ceiling and takes a two-step approach in cutting about $2.5 trillion in government spending over 10 years, according to CCH, a Wolters Kluwer business.

But the new law does not include tax increases or new tax revenues. The new law also calls for a new joint congressional committee to recommend measures for an expanded deficit reduction package before the end of the year. Some of those changes could involve heavy spending cuts and tax increases.

"What this new committee recommends could substantially change the tax code," Mark Luscombe, JD, LLM, CPA, a CCH principal tax analyst , said in a release. "A lot of attention has focused on raising taxes for high earners and there will no doubt be much debate over tax rate changes, deductions and whether the Bush-era tax cuts will be phased out at the end of 2012 as scheduled."

Read CCH's analysis of the new law at http://tax.cchgroup.com/downloads/files/pdfs/legislation/debtceiling.pdf. **RW**

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