

# Structured Kickbacks: The Fraud Within Structured Settlements

BY BOB FOIS

**I**n a case where legislation has failed to fend off internal fraud, the structured settlement industry is struggling with veiled "rebating" in the guise of commissions and/or numerical manipulation.

The sea of controversy finally prompted one settlement firm to self-regulate itself more than two years ago.

Martin Jacobson, vice president and general counsel at Creative Capital, Inc., (CCI) a nationwide structured settlement consulting company, explained that despite legal and regulatory prohibitions on the state level to prevent rebating, existing laws are being ignored.

"If you are an attorney, you cannot close your eyes to abuses which some claim are being perpetrated every day," said Jacobson.

Structured settlements of bodily injury claims offer tax-free payments providing a defendant with savings since plaintiffs receive a benefit worth more than what the defendant is spending. But Jacobson warns the present system is fraught with abuse.

CCI has developed its own legal instrument, its Certificate Of Reliability and Assurances ("CORA") to assure clients, under oath, that none of the financial abuses in manipulating awards to plaintiffs have been or will be taking place.

Jacobson complained that a common practice of labeling the rebate

as a "service fee" or as an "administrative fee" is fraudulent but the laws don't have the teeth to address this deception.

Jacobson observed that many structured settlement companies are unable to make all of the representations of fact contained in CCI's CORA certificate, an illustration of how widespread these veiled practices are throughout the structured settlement business.

Bridge Between Demand and Offer

As a technique used to settle bodily injury cases for more than two decades, structured settlements have generated annual premiums in the range of \$5-6 billion for 25-30 firms with approximately 500 agents nationwide.

"Structures can help bridge a gap between plaintiff's demand and defendant's offer," noted Jacobson. "Structured settlements can provide plaintiff with an income stream that can neither be squandered nor outlived."

Jacobson said structured settlements offer advantages to both plaintiffs and defendants. A structured settlement shields both the payment and interest earned from taxation, while also providing such benefits as absence of investment risk, management-free income and flexibility in structured payments to fit individual needs.

Jacobson noted that it should also provide protection of the plaintiff's funds against fraud and greed. Though such a settlement results in a larger payment to the plaintiff-victim, insurers don't incur the costs associated with an immediate lump sum payout. Jacobson explained that these settlements save a defendant

money, while providing a plaintiff with a benefit worth more than the defendant is spending by virtue of the tax break provided by the Internal Revenue Code. Structured settlements can be funded with United States Treasury Bonds, annuities or a blend of the two. He pointed out, however, that tighter regulation of the investments and reserves within the life insurance industry over the last 5 to 7 years has raised confidence in annuities to a point where lower yielding T-Bonds are simply no longer utilized in these settlements. Jacobson said, "The public's confidence in the strength of the life insurance industry is clearly justified."

Jacobson noted that it had been common knowledge that many structured settlement brokers have been paying part of their commissions to their casualty insurer clients for years.

Such arrangements, although tied to a percentage of commissions earned by the broker, have been called service fee or administrative fee arrangements, explained Jeffrey Borow, CCI's president, who warned that it was in the best interest of all honest structured settlement brokers to expose this inequity.

"There are defense oriented brokers such as CCI who don't play funny games with the numbers and give both sides a square deal," added Borow. "It would be a shame if CCI and other honest brokers kept quiet just as the rebating scandal became public knowledge."

CCI's stated position, however, is that such commission/kickback arrangements amount to transparent and feeble attempts to thwart the anti-rebating laws

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on the books in most states. It developed a new protection in its structured settlements, a Certificate of Reliability and Assurances ("CORA") that consists of an affidavit asserting the integrity of the process and the full disclosure of terms made under oath carrying all penalties of perjury.

CCI's CORA certificate is a series of affirmative representations and warranties certifying that CCI does not pay any service, administrative or other rebate fees to any party or insurer; does not engage in post settlement medical underwriting; always discloses the true cost of the structured settlements it negotiates; never presents present value figures which might exaggerate the value of a settlement; and is not an "in house" or captive broker owned or controlled by any insurer. "The CORA certificate ends with a warranty section that would expose CCI to civil and criminal liability if any of the statements were false," according to Jacobson.

## The Alleged Abuses: Rebating of commissions

Illegal as it might be for an insurance broker, agent or company to provide a financial incentive to the purchaser of an insurance product, such arrangements do exist and in effect reduce the cost of the premium paid for that annuity.

Jacobson pointed out that a partial return of the premium paid, or the payment of some of the commission earned on the placement of a structured settlement annuity from the broker

placing the annuity to the casualty company paying the premium, amounts to the payment of a rebate.

Labeling the rebate as a "service fee" or as an "administrative fee" is legally ineffective, he observed. Paying the rebate to a subsidiary of the carrier is also improper.

"Remember, if it looks like a duck, waddles like a duck, and quacks like a duck, it is a duck, regardless of what someone tries to convince you it is," added Jacobson.

Approximately 14 years ago, the National Structured Trade Association (NSSTA) commissioned one of the nation's leading law firms to look into this issue. In a written report, this law firm concluded that under the several hypothetical scenarios posed, it would be illegal for a structured settlement broker to share commissions with a casualty company that settled a case with a structured settlement and paid the annuity premium.

Jacobson also noted that it has been well known for years that some structured settlement companies have entered into written 'exclusive' or 'semi-exclusive' arrangements with casualty companies to rebate as much as 25% to 50% of the commissions earned.

"Of course, the term 'rebate' is not used," he added. "The arrangement and the payments are called 'service' or 'administrative' fees. However, it still waddles . . ."

## Misrepresentation of cost of the structured settlement to the plaintiff and some questions for insurers and attorneys to ponder

The failure to disclose that a rebate will be paid to the casualty insurer purchasing the structured settlement means that the cost of the structure is being overstated, CCI officials pointed out.

They noted that a misrepresentation occurs when the defense attorney represents to the court that the total cost to the defendant/insurer is X dollars -- without disclosing that part of the com-

mission is being returned to the casualty insurer.

Jacobson said this omission hides a reduction of the true cost.

"Perhaps defense counsel does not know that a rebate is being paid. Then the misrepresentation is unintentional, but it is a misrepresentation nonetheless," he said, adding that serious questions should be raised by client and counsel.

Should defense counsel have inquired? Did defense counsel turn a blind eye on a practice he or she suspected was occurring? Does the claim examiner know the truth? Is he or she present, but keeping silent while defense counsel makes a misrepresentation to the court?

Has the claim rep misled both defense and plaintiff attorneys? Does this create a risk of the case being reopened in the future when the true cost of settlement is learned? Does this create a risk of exposing the casualty insurer to class action litigation if it later becomes known that the practice was widespread? Does plaintiff's counsel bear any risk of overcharging for legal fees if fees are based on an overstated cost of settlement?

## Misrepresentation of cost of structured settlement to the defendant

Jacobson said that the assured/defendant is not always advised that its casualty insurer is receiving a rebate and that the assured/defendant is not receiving the benefit of the reduction in actual cost of the settlement. To be also considered is that an assured/defendant's premium payments for its insurance program in any given year might be based on the claims experience of the prior year.

Has the assured been fraudulently overcharged for its insurance program, leaving it with a potential claim against the carrier? Is the assured at risk of further exposure to the original claimant of having the original settlement set aside for fraud and misrepresentation?

## Misrepresentation of cost of structured settlement to the reinsurer

Assume the reinsurer has not been told and will not share the rebate, said Jacobson.

"Regardless of the percentage of reinsurance applicable, if the reinsurer is not given the benefit of the rebate paid to the insurer, then it is repaying too much money to the insurer which has failed to disclose and/or share the rebate," he added. "Has a fraud been perpetrated on the reinsurer?"

## Misrepresentation of cost to co-defendants and their carriers

If insurer "A" which insures one defendant has entered into an agreement with insurer "B" which insures a codefendant whereby they will share the cost of settlement, but fails to disclose that it is getting a rebate (thereby reducing the cost only to insurer "A"), it would seem that insurer "A" may have committed a fraud against insurer "B" or may be liable to insurer "B" for breach of contract, detailed Jacobson.

## Misrepresentation of cost to excess insurer

Failure to disclose to an excess insurer which has agreed to allow the primary insurer's rebating broker to consummate the transaction without knowing that said broker will rebate part of the commission to the primary, Jacobson noted, seems to give rise to an overpayment by the excess insurer and the accrual of a claim by the excess insurer against the primary insurer.

## Related Abuses: Rated Age Abuse i.e. medical underwriting after the settlement

Unlike most ordinary single premium annuities, the benefit provided by a fixed amount of premium actually increases the more seriously impaired the injured plaintiff happens to be, since structured settlement annuities take an injured plaintiff's life impairing medical condition

into account to determine the annuity rate to be applied to all life contingent payments.

CCI officials did not view this as a bad thing, as more benefit for the buck might help settle the case, but they cautioned there were minefields.

They raised the question of a broker representing the cost of the structured settlement at \$100,000, even providing a quote to prove it, and subsequently having the case medically underwritten to secretly reduce the cost -- instead of increasing the benefit.

"Regardless of who pockets the extra cash, a fraud has been perpetrated," stressed Jacobson. "Both the plaintiff and the defendant should benefit by the medical underwriting in the form of a greater benefit (to bridge the gap, etc.) for the dollars being spent, with full disclosure of the actual cost of the structure."

Medical underwriting should be done before settlement proposals are illustrated, he explained. In the rare case where medical reports are not available at the time of initial quoting, but where a serious and potentially life impairing injury is involved, the broker should state, on the proposal itself, that "this illustration does not take into account the plaintiff's medical condition which could enhance the benefits for the amount of premium being spent" or other words to that effect.

The rated age, the age to which plaintiff's chronological age has been increased to reflect his/her decreased life expectancy, should be disclosed in every case.

## Refusal to disclose cost

Since 1983, the IRS has taken the view that disclosure of the cost of a structured settlement does not create any constructive receipt or other tax problem for a plaintiff who knows the cost.

"Yet, for the past 19 years, we have heard stories of brokers who will state to a plaintiff, to his or her attorney, or even to the court, that disclosure of the cost is not permitted," said Jacobson. "This is simply not true."

He added that many jurisdictions mandate that attorney's fees be calculated based on cost. Ethical considerations cause many attorneys in jurisdictions that allow present value to be used to determine fees to nevertheless insist on disclosure of cost so that cost can be used to calculate fees.

## Inflated or Overstated Present Value Figures

CCI officials noted that Present Value or "PV" is a legitimate measure of the real present day value of a future stream of payments or of a single lump sum payment payable in the future

How much is \$1,000,000.00 payable in thirty years worth today? How much money would I need to set aside today, growing at compounded interest, to produce \$1,000,000.00 in thirty years?

Jacobson believed these questions underline the real reason behind structured settlements and why such fraud undermines the real value of "a stated or agreed upon cost" to a plaintiff.

"Remember, the thing that makes a good structured settlement a true win-win is the fact that a defendant can pay less for the benefit than the amount of cash the plaintiff would need to buy the same benefit stream for himself in a comparable investment," explained Jacobson. "The tax break makes the difference. The plaintiff would have to purchase a larger benefit stream because part of it would be lost to taxes."

Since plaintiff's net after tax benefits equal the tax-free benefits purchased by the defense as part of a structured settlement, the structured settlement is worth more in cash equivalent to the plaintiff than the defendant has to spend, he added.

"That is the beauty of a well-negotiated structure and how it can bridge a gap between the plaintiff's demand and the defendant's offer," said Jacobson. "However, if the discount rate (that rate of interest that one assumes the present day lump sum would grow at to produce the future benefit being offered) is understated, the PV will be overstated. If the discount rate is grossly understated,

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the PV will be grossly overstated. If the period of years of a lifetime benefit payment is overstated, as where a normal life expectancy is used in the PV calculations, but the plaintiff has a severely diminished life expectancy, the PV will be overstated. It is essential, therefore, for PV to be compared to actual cost. If the PV seems too good to be true, well . . . you know the rest."

Jacobson emphasized that honest and accurate PV figures, alongside cost, may be just what it takes to settle the case. "\$1,050,000 in honest PV that cost the defense \$950,000 on the case that was worth \$1,000,000 means that the defense saved \$50,000 and the plaintiff got an extra \$50,000 worth of value," he noted. "That's a win-win."

## In House or Captive Broker

Independence is crucial in a broker. Being tied in to a single family of life companies does not afford the opportunity to truly broker the structure. Price comparison of rates as among the various life markets available, comparative medical underwriting, etc., all become less likely, if not impossible, when the "in house" broker must be used. This is especially true since some of the most respected life companies and other structured settlement provider companies will not appoint in house or captive brokers to offer their products. Obtaining the best structured settlement for each case becomes difficult or impossible. Perhaps an annuity from a prestigious life company is unavailable because the in house or captive broker is not appointed

to offer that life company's product. The captive broker is also under pressure to place the annuity with the life company owned by or affiliated with the casualty carrier. The independent broker does not have that conflict of interest, according to Jacobson. Additionally, there may be legal prohibitions on the use of a broker affiliated with the casualty company.

## Prohibition on captive business

"When I obtained my insurance license, I had to certify that I would not place more than 10% of my total annual production on insurance products purchased by my company," said Jacobson. "This certification must be made with every license renewal."

To avoid paying commissions to unlicensed entities, which is illegal in its own right, some structured settlement brokers have advised casualty companies to form or use subsidiary companies -- which obtain a life and annuity license for the very purpose of receiving commissions on business of their parent or affiliate.

Using this approach, 100% of the commissions received by these companies are "earned" on captive business, the NSSTA report found nearly 14 years ago, specifically in regards to New York.

The report detailed Insurance Law, "in this case, the life insurance agency is a wholly owned subsidiary of the casualty insurer. If the subsidiary agency has received in the previous twelve months or will receive in the ensuing twelve months more than 10% of its aggregate net commissions on risks of the casualty insurer, its license may be revoked or suspended."

## Settlement Solution: CORA Certificate.

Jacobson is finding a growing demand for CCI's CORA certificate and the realization that many companies have already violated its guidelines.

The certificate contains the following stipulations:

- No kickbacks are paid. No rebates, service fees, administrative fees, or

other payments to the carrier paying for the structure or to any subsidiary, affiliate, partner or friend will be paid.

- The cost of the structure will be disclosed in writing.
- The rated age assigned by the life company issuing the annuity will be disclosed.
- No post settlement medical underwriting will be engaged in to secretly reduce the cost of the structured settlement.
- Legitimate, realistic and reasonable assumptions will be used to calculate present value and these will be disclosed. Present value will only be used when actual cost is also disclosed.
- The firm certifies that it is neither an in house, captive, affiliated or exclusive broker of the carrier paying for the structured settlement.

Jacobson has challenged other structured settlement brokers to adopt such standards to create a level playing field within the industry and protect the plaintiffs.

The affidavit carries penalties for perjury, making it not only a legal tool for present agreements but holds firms accountable for past actions.

Jacobson has proposed changes in New York, Insurance Law Section 4224 (c) and New Jersey Rev. Stat. 17:29A-15, but he isn't waiting for the state legislatures.

"If you work for an insurer that does not engage in these abuses, you must insist on the highest standards of professional practice. Your reputation and perhaps your insurance license (or your employer's license) also depend on it," stated Jacobson. "Structured settlements, when honestly and ethically negotiated are good for all parties involved in the litigation. Whoever you are; whomever you represent; accept nothing less, for your client, for your company, for yourself." And for those companies engaged in any of the various forms of structured settlement fraud, "the CRACKDOWN is coming", said Jacobson. !

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