CREATIVE CAPITAL INC.

THE LEADER IN CREATIVE STRUCTURED SETTLEMENTS

SPECIAL MESSAGE

To: Attorneys, Adjusters, Insurers, and all Consumers of Structured Settlements

From: Martin Jacobson, Esq., Vice President and General Counsel

Date: January, 1999

Re: CCI's ***Certificate of Reliability and Assurances***

Introduction

Structured settlements have been in use as a technique for settling cases for approximately two decades. Structures can help bridge a gap between plaintiff's demand and defendant's offer. Structured settlements can provide plaintiff with an income stream that can neither be squandered nor outlived. Structured settlements can be funded with United States Treasury Bonds, annuities or a blend of the two. Structured settlements can 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*. In short, structured settlements can provide the parties with a win-win result.

Structured settlements can also be a tool for abuse. We at Creative Capital have been shown a letter of complaint which has allegedly been sent to several state insurance departments, state Attorneys General, and the Internal Revenue Service. In that letter serious allegations are made against at least one major casualty insurer and several structured settlement brokers. We have been told that an investigation is underway to look into these allegations. We hope the investigations are speedily conducted and that any such abuses are ended once and for all.

We at Creative Capital do not know whether these allegations are true or false. However, since these allegations are very serious (and could lead, if proved, to civil and/or criminal penalties being levied against those accused), we decided to advise all of our clients (past, present and future), colleagues, associates, and friends that CCI is the only structured settlement consulting group to offer a ***CERTIFICATE OF RELIABILITY AND ASSURANCES ("CORA").*** The CCI consultant handling your case will make certain representations, in writing, so that you will know that no abusive, illegal or questionable practice has occurred.

This certificate will also contain representations that none of the abuses being alleged against structured settlement brokers generally in the marketing material of a prominent consultant has taken place in your case.

CCI, by these efforts, is setting itself apart from those structured settlement brokers who cannot make **all** of the representations we offer to make in every case. CCI is redefining the standards of our industry. If any broker refuses to make each and every one of the representations and warranties set forth in our ***CERTIFICATE OF RELIABILITY AND ASSURANCES***, their services should not be used and their structured settlement should be rejected. Make no mistake about it. If you are an attorney, you cannot close your eyes to abuses which some claim are being perpetrated every day. Your professional reputation and license depend upon it. 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 depends upon it. If you are a claimant, you are entitled to the full benefit of the bargain you think you have made. To accept less is to adopt the often quoted, but defective reasoning: "you can't fight City Hall." 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.

The Alleged Abuses

1. **Rebating of commissions**. Rebating of insurance commissions has been illegal in virtually all states for decades. It is simply illegal for an insurance broker, agent or company to provide a financial incentive to the purchaser of an insurance product, such as an annuity, which in effect reduces the cost of the premium paid for that annuity. 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 providing the premium would amount to the payment of a rebate. Labeling the rebate as a "service fee" or as an "administrative fee" is cute, but ineffective. 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.

   Approximately 10 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. Notwithstanding this report, which was circulated in our industry, 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. The arrangement and the payments are called service or administrative fees. However, it still waddles . . .

2. **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. Thus, where the defense attorney has represented to

the court, as is often required by court rule, practice, and/or statute, that the total cost to the defendant/insurer is X dollars, without disclosing that part of the commission is being returned to the casualty insurer (thereby reducing the true cost), a misrepresentation has occurred. Perhaps defense counsel does not know that a rebate is being paid. Then the misrepresentation is unintentional, but it is a misrepresentation nonetheless. 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? Are he or she present, but keeping silent while defense counsel makes a misrepresentation to the court? Has he/she 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?

3. **Misrepresentation of cost of structured settlement to the defendant.** Assume the assured/defendant has not been 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. Assume further that the assured/defendant's premium payments for its insurance program in any given year are based on the claims experience of the prior year. Has a fraud been perpetrated on the assured? Has the assured been overcharged for its insurance program? Does the assured have 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?

4. **Misrepresentation of cost of structured settlement to the reinsurer.** Assume the reinsurer has not been told and will not share the rebate. 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. Has a fraud been perpetrated on the reinsurer?

5. **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 co-defendant 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.

6. **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, 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.

7. **Failure to declare rebate as income on corporate tax return.** The complaint allegedly filed with the agencies set forth above also claimed that the casualty insurer illegally failed

to declare millions of dollars in rebate income on its tax return thereby constituting a potential tax fraud with possible civil and/or criminal penalties.

[Items numbered 8 – 12 below were not contained in the letter, but are alleged abuses which must be addressed.]

8. **Rated age abuse, i.e. medical underwriting after the settlement**. Unlike ordinary single premium annuities, 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. Thus, the benefit provided by a fixed amount of premium actually increases, the more seriously impaired the injured plaintiff happens to be. This is not a bad thing. More benefit for the buck may help settle the case. But what if the broker represents the cost of the structured settlement at $100,000 and even provides a quote to prove it, and subsequently has 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. 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. 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.

9. **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 15 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 would destroy the structure. This is simply not true. Moreover, 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.

10. **Inflated or overstated present value figures**. 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? These are legitimate questions, especially if we are attempting to measure the real value to the plaintiff of what the defendant is proposing at a stated or agreed upon cost. 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. 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. 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. 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, 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. 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. That's a win-win.

11. **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. Comparative ratings 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 a Treasury Bond structure is more suitable for the case and for the plaintiff, but the affiliated or captive broker is limited to placing the structure with an affiliated or captive life insurer which does not offer the Treasury Bond structure needed. 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. Additionally, there may be legal prohibitions on the use of a broker affiliated with the casualty company. (See below.)

12. **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. This certification must be made with every license renewal. Yet, to attempt 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 is "earned" on captive business. As stated in the report written for NSSTA 9 years ago, in a section referring to New York 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."

The Solution

CREATIVE CAPITAL'S CERTIFICATE

OF RELIABILITY AND ASSURANCES

CCI is the only structured settlement consulting firm whose consultants will certify, under oath, that none of the abuses set forth above have or will take place . To give added significance to our CORA certificate, each certificate contains the CCI consultant's affirmative **representations and warranties** as to the accuracy of the facts set forth therein. Such statements are unheard of in the structured settlement industry and set a new and higher standard of practice for others to follow. Sadly, many other companies will be unable to make all of the representations of fact contained in CCI's CORA certificate.

Set forth below are the items contained in the actual *certificate.*

LIST OF REPRESENTATIONS AND WARRANTIES

1. CCI does not pay kickbacks. We can not say it more directly. 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.

2. CCI will disclose the cost of the structure, in writing.

3. CCI will disclose the rated age assigned by the life company issuing the annuity.

4. CCI will not engage in post settlement medical underwriting to secretly reduce the cost of the structured settlement.

5. CCI will only use legitimate, realistic and reasonable assumptions in calculating present value and CCI will always disclose those assumptions. Moreover, present value will only be used when actual cost is also disclosed.

6. CCI will certify that it is neither an in house, captive, affiliated or exclusive broker of the carrier paying for the structured settlement.

All of these representations and warranties will be made **UNDER OATH AND PURSUANT TO THE PENALTIES FOR PERJURY.** Whether you are a plaintiff or defense attorney; an adjuster or claim examiner; insurer, reinsurer, excess insurer; or insurer for a co-defendant; plaintiff or defendant; don't you deserve these representations from the structured settlement broker? Shouldn't you require them? Can you accept less?

Legal Notice: This special message, the other items contained on CCI's web page, as well as CCI's newsletter and other mailings, are published from time to time by Creative Capital Inc. CCI has offices throughout the United States and in the United

Kingdom. These publications inform clients, friends, and fellow professionals of developments in the law as it pertains to structured settlements, periodic judgments, personal injury practice and insurance law generally. These publications are available free of charge to interested parties. The articles appearing in these publications do not constitute legal advice or opinion. Such advice and opinion should be obtained by our readers from their own counsel with respect to specific factual situations. For more information, contact Martin Jacobson, Esq., Vice President and General Counsel, 800-327-9224 [800-EASY-CCI] or email mj@creative-capital.com.