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BILL ANALYSIS

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Senate Bill 541 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Alan Sanborn
Committee: Judiciary

Date Completed: 3-20-06

RATIONALE

Some people believe that the State should adopt a new version of the Structured Settlement Protection Act, which was enacted in 2000. This law governs the sale or other transfer of the right to receive periodic payments under structured settlement agreements. These agreements are often entered into by the parties to a personal injury lawsuit, particularly in a case involving severe or catastrophic injuries. Typically, the liable party or the party's insurer purchases an annuity contract that will provide the injured party or his or her dependents (the payee) with periodic, tax-free payments over time. In some cases, after the structured settlement arrangement has been established, the payee may wish to sell his or her right to receive the payments in exchange for a lump sum amount, especially if the payee needs an influx of cash to meet changed financial circumstances. A structured settlement purchaser, or "factoring company", may purchase the right to receive the periodic payments at a discounted rate, which reflects the time value of money and the cost of doing business.

The Structured Settlement Protection Act was enacted to address problems that sometimes occurred when payees transferred their payments rights for an unreasonably large discount. Reportedly, in some cases, the amount received was half or less than half of the present value of the payments sold. Then, when the lump sum cash was gone, some payees evidently ended up on public assistance and/or sued the insurance company for permitting the transfer. Another concern involved the loss of tax-free status to the payee once the periodic payments were exchanged for a lump sum payment. The Act therefore limits the circumstances under which a payee may sell or otherwise transfer his or her right to receive structured settlement payment rights.

Specifically, under the Act, if the right to receive payments is prohibited or restricted in a contract or other agreement, the payee may not transfer the right without court approval. The court must find that the transfer is necessary for the payee and/or his or her dependents to avoid imminent financial hardship, and that the payee received independent professional advice regarding the financial and legal effects of the transfer. In addition, each "protected party" (the payee, his or her dependents and beneficiaries, an annuity insurer, the party obligated to make the payments, and any party entitled to invoke the contractual restriction on the transfer) must consent to the transfer.

Some people believe that these provisions are excessively restrictive, and that Michigan should replace the current Act with one that more closely tracks a model structured settlement protection act adopted in 2004 by the National Conference of Insurance Legislators (NCOIL). This act, which replaced an earlier model act, was adopted after the U.S. Congress amended the Internal Revenue Code in 2002 to provide for the tax treatment of structured settlement payment rights transfers. Under Section 5891 of the Code, a transferee (the person purchasing the payment rights) must pay a tax on the "factoring discount" *unless* the transfer has been approved by an order or judgment of a court or responsible administrative authority, which must find that the transfer is in the best interest of the payee, taking into account the welfare and

support of his or her dependents, and does not contravene Federal or state law.

Like the Federal law, the NCOIL model act uses the "best interest of the payee" standard. Also, the act gives interested parties the opportunity to oppose a proposed transfer, but it does not require their consent, and it requires that payees be advised to seek independent professional advice, but does not require them to obtain the advice. It has been suggested that Michigan should adopt these provisions.

CONTENT

The bill would enact the "Revised Structured Settlement Protection Act" and repeal the Structured Settlement Protection Act. The bill would do the following:

-- Provide that a transfer of structured settlement payment rights would not be effective unless the transfer had been approved in a final court order or order of a responsible administrative authority.
-- Require a transfer to be in the best interest of the payee, considering the welfare and support of his or her dependents.
-- Require the court or responsible administrative authority to find that a payee would suffer imminent financial hardship if a transfer were not approved, and the transfer would not leave the payee unable to pay living expenses, if the structured settlement obligor objected to the transfer based on a restriction against assignment.
-- Require the transferee to have advised the payee to seek independent professional advice regarding the transfer.
-- Require the transferee to give a payee a disclosure statement, including the discounted present value of the payments to be transferred, at least three days before the payee signed a transfer agreement.
-- Require the transferee to file certain documents with the court or responsible administrative authority and serve them on all interested parties before the hearing on the transferee's application for approval of the transfer.
-- Require the filed documents to include notice that an interested party could support, oppose, or otherwise respond to the application.

Definitions

The bill would define "structured settlement" as an arrangement for periodic payment of damages for personal injuries or sickness established by settlement or judgment to resolve a tort claim. The term would not include an arrangement for periodic payments to settle a worker's compensation claim.

"Structured settlement payment rights" would mean rights to receive periodic payments under a structured settlement, whether from the structured settlement obligor or the annuity issuer, if one or more of the following conditions exist:

-- The payee is domiciled, or the domicile or principal place of business of the structured settlement obligor or the annuity insurer is located, in this State.
-- The structured settlement agreement was approved by a court or responsible administrative authority in this State.
-- The structured settlement agreement is expressly governed by the laws of this State.

"Structured settlement agreement" would mean an agreement, judgment, stipulation, or release embodying the terms of a structured settlement.

"Payee" would mean the individual who receives tax free payments under a structured settlement and who proposes to make a transfer of payment rights under the structured settlement. "Structured settlement obligor" would mean a person that has a continuing obligation to make periodic payments to a payee under the structured settlement agreement or a qualified assignment agreement (an agreement providing for a qualified assignment as defined in a section of the Internal Revenue Code). An "annuity issuer" would be an insurer that has issued a contract to fund periodic payments under a structured settlement.

"Responsible administrative authority" would mean a government authority vested by law with exclusive jurisdiction over the settled claim resolved by the structured settlement.

"Transfer" would mean a sale, assignment, pledge, hypothecation, or other alienation or encumbrance of structured settlement payment rights a payee makes for consideration. The term would not include the creation or perfection of a security interest in structured settlement payment rights under a blanket security agreement entered into with an insured depository institution, unless action had been taken to redirect the payments to the institution, or otherwise to enforce the blanket security interest against the structured settlement payment rights.

Disclosure Statement

Under the bill, at least three days before the date on which a payee signed a transfer agreement, the transferee would have to give the payee a separate disclosure statement in at least 14-point bold type, setting forth all of the following:

-- The amount and due dates of the structured settlement payments to be transferred.
-- The aggregate amount of the payments.
-- The discounted present value of the payments to be transferred, which would have to be identified as the calculation of current value of the transferred payments under Federal standards for valuing annuities, and the amount of the applicable Federal rate used in calculating the discounted present value.
-- The gross advance amount.
-- The net advance amount.
-- The amount of penalties or liquidated damages payable by the payee if he or she breached the transfer agreement.
-- An itemized listing of all applicable transfer expenses, other than attorney fees and related disbursements payable in connection with the transferee's application for approval of the transfer, and the transferee's best estimate of the amount of the fees and disbursements.
-- A statement of the payee's right to cancel the transfer agreement without penalty or further obligation by the third business day after the date he or she signed the agreement.

("Discounted present value" would mean the present value of future payments determined by discounting the payments to the present using the most recently published applicable Federal rate for determining the present value of an annuity, as issued by the Internal Revenue Service. "Gross advance value" would mean the sum payable to the payee or for the payee's account as consideration for a transfer of structured settlement payment rights before reduction in that sum for transfer expenses or other deductions. "Net advance amount" would mean the gross advance amount less the aggregate amount of the actual and estimated transfer expenses required to be disclosed.

"Transfer expenses" would mean all expenses of a transfer that the transfer agreement required the payee to pay or have deducted from the gross advance amount, including court filing fees, attorney fees, escrow fees, lien recordation fees, judgment and lien search fees, finders' fees, commissions, and other payments to a broker or other intermediary. Transfer expenses would not include preexisting obligations of the payee that were payable for his or her account from the proceeds of a transfer.)

Application for Approval

A transferee could apply for approval of a transfer of structured settlement payment rights with the court or responsible administrative authority in the county in which the payee resided or in which the structured settlement obligor or the annuity issuer maintained its principal place of business, or with the court or responsible administrative authority that approved the structured settlement agreement.

At least 20 days before the scheduled hearing on the application, the transferee would have to file with the court or responsible administrative authority, and serve on all interested parties, a notice of the proposed transfer and the application for its authorization, and include all of the following with the notice:

-- A copy of the transferee's application.
-- A copy of the transfer agreement.
-- A copy of the disclosure statement.
-- A listing of each of the payee's dependents and each dependent's age.

-- Notice that any interested party would be entitled to support, oppose, or otherwise respond to the application, in person or by counsel, by submitting written comments to the court or administrative authority or by participating in the hearing.
-- Notice of the time and place of the hearing and of the manner in which and the time by which written responses would have to be filed to be considered by the court or administrative authority.

The time for filing written responses would have to be at least 15 days after service of the notice.

("Interested party" would mean the payee, a beneficiary irrevocably designated under an annuity contract to receive payments following the payee's death, an annuity issuer, a structured settlement obligor, or any other person with continuing rights or obligations under the structured settlement.)

Approval of Transfer

A direct or indirect transfer of structured settlement payment rights would not be effective, and a structured settlement obligor or annuity issuer would not be required to make a payment directly or indirectly to a transferee of structured settlement payment rights, unless the transfer had been approved in a final court order or order of a responsible administrative authority. The order would have to be based on express findings of all of the following:

-- The transfer was in the payee's best interest, taking into account the welfare and support of his or her dependents.
-- The transferee had advised the payee, in writing, to seek independent professional advice regarding the transfer, and the payee had received advice or knowingly waived in writing the opportunity to seek advice.
-- The transfer did not contravene an applicable statute or order of the court or other governmental authority.
-- The discount rate or rates used in determining the discounted present value of the structured settlement payments to be transferred did not exceed 25% per year.

("Independent professional advice" would mean advice of an attorney, certified public accountant, actuary, or other licensed professional adviser.)

In addition, if the transfer were inconsistent with a restriction against assignment in the structured settlement agreement and if the structured settlement obligor objected to the transfer based on the restriction before the hearing, the order would have to include all of the following findings:

-- The payee would suffer imminent financial hardship if the transfer were not approved.
-- The transfer would not render the payee unable to pay current or future normal living expenses.
-- The transfer order would restrict payment of the gross advance amount to direct payment to the provider of the goods or services that were the subject of the imminent financial hardship.

If the total cost of the goods or services could not be readily determined at the time of or within a reasonable time after the transfer, the court could exercise reasonable discretion in ordering the direct payments.

"Imminent financial hardship" would mean the inability of the payee, because of a change in his or her circumstances after the execution of the initial structured settlement agreement, to purchase or pay for one or more of the following without the transfer:

-- Medical care or a medical device for the payee or his or her dependents.
-- Living quarters for the payee.
-- A motor vehicle necessary for the payee's transportation if the payee had no other suitable transportation options.
-- Education or job training expenses.
-- Debts of the payee resulting from child support, alimony, a tax lien, funeral expenses, or a judgment.

Effects of Transfer

A transfer of structured settlement payment rights would have the effect of discharging and releasing the structured settlement obligor and the annuity issuer from all liability for the transferred payments as to any person except the transferee.

The transferee would be liable to the obligor and annuity issuer for the taxes they incurred as a consequence of the transfer if it contravened the terms of the structured settlement. The transferee also would be liable to the obligor and annuity issuer for other liabilities or costs, including reasonable costs and attorney fees, arising from the obligor's and annuity issuer's compliance with the order of the court or responsible administrative authority or from the transferee's failure to comply with the proposed Act.

An annuity issuer or a structured settlement obligor would not be required to divide a periodic payment between the payee and a transferee or assignee or between two or more transferees or assignees.

A payee could make a further transfer of structured settlement payment rights only after complying with all of the requirements of the Act.

Other Provisions

A payee could not waive a provision of the proposed Act.

A transfer agreement entered into on or after the Act's effective date by a payee residing in this State would have to provide that disputes under the agreement, including a claim that the payee had breached the agreement, would be determined in and under the laws of Michigan. A transfer agreement could not authorize the transferee or any other person to confess judgment or consent to entry or judgment against the payee.

A transfer of structured settlement payment rights that were life-contingent would not be effective unless, before the payee signed the transfer agreement, the transferee had established and agreed to maintain procedures reasonably satisfactory to the structured settlement obligor and the annuity issuer for periodically confirming the payee's survival, and for giving the obligor and the annuity issuer prompt notice in the event of the payee's death.

A payee who proposed to make a transfer of structured settlement payment rights could not incur a penalty, forfeit an application fee or other payment, or otherwise incur liability to the proposed transferee or assignee based on the failure of the transfer to satisfy the conditions of the proposed Act.

A transferee would have sole responsibility for complying with the requirements for a disclosure statement and fulfilling the conditions for approval of the transfer. A structured settlement obligor or annuity issuer would not bear any responsibility or liability arising from a transferee's failure to comply with those requirements or to fulfill those conditions.

The proposed Act would not authorize a transfer of structured settlement payment rights in contravention of law or validate or invalidate a transfer under an agreement entered into before the Act's effective date.

Application of Act

The proposed Act would apply to a transfer of structured settlement payment rights under an agreement entered into on or after the 30th day following the Act's effective date.

The existing Act would be repealed effective 30 days after the effective date of the proposed Act.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Structured settlements are designed to provide a reliable income stream to injured parties and their dependents, and prevent payees from squandering or unwisely investing the lump sum award they otherwise might receive in a settlement or judgment. Selling the right to receive periodic payments can undermine the protections built into a structured settlement, especially for someone not accustomed to managing a large sum of money. A structured settlement protection law helps ensure that injured parties are not victimized by unethical factoring companies that induce people to sell their payment rights at huge discounts. Circumstances can change, however, and a payee might find the need for a lump sum of cash—to make a down payment on a house, renovate a home so that it is barrier-free, purchase or modify

a vehicle, invest in a business, or care for an ill child or an aging parent, for example.

Michigan's Structured Settlement Protection Act excessively limits payees' ability to sell their structured settlement payment rights. In particular, by requiring the consent of all of the "protected parties", the Act essentially gives annuity issuers and insurance companies, with which injured parties settled their lawsuits, the power to veto a proposed transfer of settlement payments—regardless of the circumstances and regardless of whether the court finds that a transfer would prevent imminent financial hardship to the payee. While the model act still allows insurers and other interested parties an opportunity to object to a transfer, it gives the ultimate decision-making authority to the court, which is in the best position to determine whether a transfer should be approved.

Furthermore, Michigan's "imminent financial hardship" standard prevents most payees from selling their payment rights, since they may have a legitimate medical or family need that does not constitute an imminent financial hardship. This standard also is out of the mainstream. Under the Internal Revenue Code and the NCOIL model act, a transfer must be in the best interest of the payee, taking into account the welfare and support of his or her dependents. Of the 43 states that have adopted some version of the NCOIL act, the vast majority use the "best interest" standard, according to the National Association of Settlement Purchasers.

In addition, while it makes sense to ensure that payees are advised to seek independent professional advice, they should not be required to do so as a condition of selling their payment rights. This requirement imposes an additional expense on payees, who might not need or want the advice.

The Revised Structured Settlement Protection Act proposed by the bill closely tracks the NCOIL model act. Compared with the current law, the proposed Act would more fairly balance the interests of payees and the rights of insurers, while retaining reasonable protections for injured parties.

Supporting Argument

The bill represents a compromise between giving insurers and annuity issuers "veto power" over a proposed transfer and simply allowing them to object to a transfer. Under current law, an insurer or annuity issuer has a so-called veto power because that party has a contractual interest in the structured settlement, and is obligated to make the payments. There is a concern that if an insurer consents to a transfer and it is approved, and the payee squanders the lump sum he or she receives, the payee or his or her dependents or beneficiaries then will sue the insurer for giving its consent. Evidently, this did in fact occur: The insurer lost the lawsuit and essentially was forced to pay twice.

Under the bill, if an insurer or annuity issuer objected to a proposed transfer that conflicted with a restriction in the structured settlement agreement, the court or responsible administrative authority could not approve the transfer unless it were necessary to avert imminent financial hardship to the payee, the payee still would be able to pay current and future living expenses, and payment would be made directly to the provider of the goods or services that were the subject of the imminent financial hardship. These provisions would preserve the ability of an annuity issuer or insurer to limit its exposure to liability by blocking a transfer that was not financially essential to the payee. At the same time, the bill would enable a payee to make a transfer over the objections of the insurer or annuity issuer, if it were necessary for medical expenses, living quarters, a motor vehicle, education or job training, or other debts specified in the bill. By requiring direct payments to the provider, the bill would ensure that the payee did not receive a lump sum payment that could be squandered.

Opposing Argument

The bill would significantly lessen consumer protections. When a person wishes to sell rights to structured settlement payments in exchange for a lump sum of cash, the concerns that existed at the time the structured settlement agreement was reached are still present: the need to ensure a reliable income stream for the payee and his or her dependents, prevent the payee from wasting or losing a lump sum payment, and protect the payee from having to pay taxes on a lump sum payment. Most people who receive structured settlement payments entered into

the agreement with the advice of an attorney, and most payees need a structured settlement because they do not have the expertise to manage large sums of money. If transfers of payments are rare, it is because the circumstances justifying them are rare.

In addition, the bill would shift the burden under the law. Currently, a transferee has the burden of obtaining the consent of all protected parties. Under the bill, however, the interested parties--including beneficiaries--would have the burden of opposing a transfer. To object effectively, an interested party likely would have to go to the effort and expense of attending the hearing and retaining an attorney.

Furthermore, when structured settlement agreements are entered into, the costs of administering them are set. The agreements do not contemplate future transfers or factor in the costs of having to object to a transfer or respond to a lawsuit challenging an approved transfer. If transfers became more commonplace, insurance costs could rise or the number of structured settlements or the amount available to injured parties could be reduced. Either result would be detrimental to insurance purchasers and injured parties.

Response: The bill actually would broaden consumer protections because it would apply to all proposed transfers of structured settlement payment rights, while the current law applies only if a transfer is restricted in a contract or other agreement.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have a minimal impact on local courts regarding the process for approving the transfer of structured settlement payment rights. The terms laid out in the bill pertain primarily to the requirements of the parties.

Fiscal Analyst: Stephanie Yu

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.