

Counsel's Peril and Client's Salvation: Finding the Right Financial Plan for the Tort Victim

By Richard G. Halpern

1. Get the settlement for the injured plaintiff. Shake hands.
2. Collect fee.

Today, there is growing consensus that an attorney following the time tested formula above is courting disaster -- for himself, and his client. The consequences to the attorney may include malpractice. The consequences to the client, however, are worse: financial catastrophe.

Prior to the advent of structured settlements as a routine option, it was beyond debate that agreement on a settlement amount or the declaration of a damages verdict ended an attorney's obligation to his or her client. What remained — what to do with the cash — was in another professional realm entirely, that of the financial specialist.

In the age of structured settlements, knowledge of settlement options is an essential component of the plaintiff's attorney's training if he or she is going to competently discharge the duty of an advisor. Telling an injured plaintiff that certain options entail certain well-documented risks is now required by the attorney's duty of communication. Like it or not, structured settlements are part of the representation relationship. For the attorney, it is a matter of competence.

For the client, it is more a matter of survival. The typical personal injury victim has little experience managing large sums of money. All observers seem to be in agreement that the likelihood of a recipient of a lump-sum settlement squandering his money on discretionary purchases, gifts to family and friends, and bad investments is unacceptably high. Financial planning, in other words, is imperative. Structured settlements are one category of financial planning that may be appropriate, but there are other options as well. The key point to remember, in advising your client, is this: the principles of financial planning for negligently injured people and their families are profoundly different from those applied to the typical clients of financial planners, stock brokers, bank trust departments, and insurance agents.

Let's examine why, beginning with the traditional annuity-based structured settlement, what I often refer to as a "defense-controlled" structured settlement. This is an appropriate term because this form of structured settlement is covered by Section 130 of the Internal Revenue Code, which requires that the structure must be part of the settlement agreement and thus must be implemented by the defense. The defense frequently uses the leverage bestowed by this provision to steer the settlement into insurance annuity products (which is the reason the Section was devised in the first place...but that's another story).

A structured settlement is, by definition, fixed amount periodic payments over a certain time. The defense-controlled structured settlement using annuities has other characteristics as well, including:

Rigid Interest Rates.

This is a real problem, at a time when interest rates are at historic lows. With an annuity-based structured settlement, these rates are locked in...and they are virtually certain to rise. What does this mean? Invariably, rising interest accompanies rising inflation, so while costs are rising for the injured former-plaintiff, perhaps dramatically, income remains constant. While being locked into low interest rates is not terrifically appealing to an everyday investor for whom the income is supplementary, it is potentially disastrous for a victim whose every need must be paid for by an income stream that loses purchasing power over time.

The Continuing Threat of Dissipation.

Once upon a time, preventing dissipation was the selling point for defense-controlled structured settlements. Now any successful litigant near a TV set can see an 800 number that will rapidly put him and his annuity structured settlement in the clutches of a company ready, eager, and willing to pay 35 cents on the dollar or less for all future payments. Interestingly, this development arguably makes annuities a riskier option than lump sum settlements, for at least when a lump sum recipient dissipates the money, he has the full amount to dissipate.

The Risk of Commercial Failure.

The flurry of insurance company failures at the beginning of this decade exposed a deep fault line in the supposed security of annuity investments. While it is certainly true that most insurance companies will not fail, it is also certainly true that the Standard and Poor's, Best's, Moody's, and Duff and Phelps' ratings no longer can be taken as a guarantee of stability, just as its highly favorable ratings of the Executive Life companies did not give any hint of their imminent collapse. With the percentage of insurance company assets in high-risk investments at an all-time high, and the ominous volatility of the economy, insurance companies, even the largest and most prestigious, must be regarded with caution. No victim of negligence dependant upon annuity income can say with 100% certainty that the income is safe. For individuals with no risk tolerance, that is unacceptable.

Sleight of Hand.

Long suspected and now confirmed are a range of maneuvers by claims carriers designed to use defense-controlled structured settlements for illicit profit. These include under-the-table kickbacks and rebates from brokers, post-settlement underwriting, and cash-refund annuities, where the claims carrier, not the plaintiff's estate, receives any left-over funds when the annuitant dies prematurely.

There is a lot to be wary of here.

But there is also a lot to be wary of in the typical approach of financial planners, stockbrokers, mutual fund managers and bank trust departments, which springs from one basic principle of investment: the greater the potential pay-off, the greater the risk to the investor.

For all clients of these industries are "asset accumulators;" logic tells us so. People who do not accumulate wealth have none to invest. These same clients emphasize performance over safety, just as the financial institutions judge employees on their success in maximizing return.

But the vast majority of injured plaintiffs are not asset accumulators. They are the opposite -- asset dissipaters. Their emotional condition, following their trauma, exacerbates this deficit by preconditioning them to spend their new-found wealth. Deprived of pleasure for so long, living with pain and an uncertain future, these individuals characteristically respond with lavish purchases of houses, cars, and luxury items. For the same reason, these individuals are naturally more sensitive to the travails of others. Knowing what it is to feel powerless in a crisis, the profoundly injured have enormous empathy for those who are suffering (or those who say they are suffering). This creates a greater tendency to dissipate funds that they desperately need, by reaching out to help others.

The financial services industry considers none of this, because the behavior and mind set is so far outside the norm. Similarly, the impact of various types of grievous injuries, not only on the client's needs but also on the client's ability to direct the management of his assets is never considered. For example, a closed head injury can cause an individual to make rash decisions, ordering brokers to liquidate assets or make imprudent investments.

This mismatch of the experience of the financial services industry with the reality of the injured plaintiff creates, predictably, an investment setting that is antithetical to the best interests of your client; particularly with stockbrokers, mutual fund raiser, life insurance company brokers and financial planners.

These are:

1. An emphasis on performance over safety.
2. A lack of dissipation safe-guards.
3. Regulations that require only that investments be “legal”, not that they be “appropriate.”

Safer, and more appropriate for such a specialized task, are major bank trust departments. Unlike mutual funds, they offer full financial planning. Their investment management resources include a family of mutual funds, many of which are appropriate for use in a tort victim’s portfolio. And “appropriate” is the word that is relevant here: regulations require that investments be both “legal” and “appropriate.” Trustees are held accountable if investments are not properly suited to the specific needs of the trust beneficiary -- exactly the element missing in the alternatives above.

There is a proverbial fly in the ointment, however: banks have little or no specialized experience managing money for individuals pre-disposed to dissipating their assets. This potentially fatal flaw can be addressed if the bank works in tandem with a special breed of financial planner — those who specialize in serving negligently injured victims and their families.

Unfortunately, there are many who claim to belong to this bloodline, and few who qualify.

Here is the acid test:

- Does the financial planner have documented experience with three hundred or more tort victims? Less than that, and you are dealing with an apprentice at best.
- Does the financial planner have an ongoing relationship with two or more major banks to serve as trustee?
- Will the financial planner arrange for significant discounts from the bank’s fee?

Once the knowledge and experience of such a financial planner is teamed with the investment acumen and security provided by a major bank, the special needs and proclivities of tort victims will be imbedded in the asset management process...where it belongs. The plaintiff’s counsel’s duty is to make sure the client can make an informed decision, for it is, after all, a decision that will have a critical effect on an injured victim’s future, for better or ill. That means helping the client resist the siren song of those who do not understand the tort victim’s special vulnerability, while seeking out the professionals whose track record shows that they do.