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What Counsel Must Know about the U.S. Treasury Bond Structured Settlement Trust — and Why

By Richard G. Halpern

The vital starting point is this:

Structured settlements do not have to use annuities issued by insurance companies. Internal Revenue Code Section 130 (the section covering tax-exempt structured settlements) provides that a "Qualified Funding Asset" [Translation: the device that funds the periodic payments of a structured settlement for an injured victim] may be any annuity or contract issued by... an insurance company... OR, any obligation of the United States. That is, U.S. Treasury Bonds.

The advantage of relying on T-Bonds rather than commercial annuities is evident: annuity carriers can default, and do, leaving injured victims who are dependent on annuity income in dire straits. U.S. Treasury Bonds are absolutely secure, unless you believe that the U.S. Treasury is going to collapse.

The U.S. Treasury Bond Structured Settlement Trust is created through these steps:

1. The plaintiff provides the defendant with a release or another form of cessation of action in exchange for cash paid upon settlement and the promise of future periodic payments. (This is exactly the procedure used with an annuity structured settlement.)
2. The defendant then assigns (with the plaintiff's assent) its liability to make the future periodic payments, the assignment going to a dedicated trust created for this purpose. The Trust (like the assignment corporations used in annuity structured settlements) serves as the "qualified assignee" required by the aforementioned Section 130, and receives the cash from the defendant.
3. The Trust is administered by a national bank, acting as Trustee.
4. After paying fees and expenses, the bank uses the cash to purchase United States Treasury Bonds in amounts sufficient to cover all periodic and lump sum payments.
5. The bank as Trustee further provides financial security for the plaintiff in the form of a security interest in the bonds being held by the Trust. [This is documented in assignment agreement, as well as in the Trust.]

The IRS' acknowledgement that the use of a dedicated trust with a bank trustee complies with the Code tax requirements on structured settlements is significant. It means that there is universal agreement that plaintiff's attorneys can advise their injured plaintiff clients that their critical objectives in a structured settlement can be achieved without any of the risks associated with the more common annuity-based structured settlements:

- **There is no risk of financial failure**—all future payments are backed by U.S. Treasury Bonds with the full faith and credit of the U.S. Government as the guarantor.
- **There is no risk of future insurance company insolvency**, as no insurance company is involved.
- **There is no risk of failure of the Trustee**, because the Trustee is a National Bank. If the bank becomes insolvent, the Federal Deposit Insurance Corporation (FDIC) is the successor Trustee until a successor trustee is chosen.
- **There is no risk of loss of either the money to fund the structured settlement, or the bonds themselves to create the benefit stream**, as all Trust assets are held outside of the other operations of the bank and are not subject to the bank's creditors in any type of default.
- **There is no risk of interruption of the income stream**, because the United States Government-backed U.S. Treasury Bonds generate the income that supports the payments from the Trust, unlike an annuity settlement, which derives its income from insurance company investments.'

Practice Implications for Counsel

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Unfortunately, plaintiff's counsel's job has become more demanding. With the official sanction of the U.S. Treasury Bond Structured Settlement Trust, it appears that plaintiff's counsel has an affirmative duty under the Rules of Professional Conduct of most states to at least make the plaintiff aware that this risk-free alternative to conventional settlements exists.

Rule 1.4(b) of the ABA Model Rules provides that *"A lawyer shall explain a matter to the extent reasonably necessary to permit a client to make informed decisions regarding the representation."*

It is hard to imagine that the existence of a safer alternative to a settlement proposal with far-reaching effects on the future of the plaintiff would not be regarded as a "necessary" component of a plaintiff's informed consent.

There is also growing consensus that attorneys not possessing a basic level of understanding about structured settlement options may not be providing "competent" representation under the rules. **Rule 1.1, *Competence***, states: *"...Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation."*

It would seem unreasonable for an attorney not to have the requisite knowledge to alert a plaintiff to a structured settlement option that avoids significant risk.

The objection raised by some attorneys that the subject matter of structured settlements crosses into non-legal territory, in effect "letting them off the hook," is belied by the language of **Rule 2.1, *Advisor*:** *"...In rendering advice, a lawyer may refer not only to law, but to other considerations such as moral, economic, social and political factors, that may be relevant to a client's situation."*

Again, there should be no question of the "relevance" of an IRS-approved structured settlement option to a client's "situation."

The point here is not to raise fears of legal malpractice or disciplinary action, but rather to demonstrate that **good** practice in injured plaintiff representation now requires counsel to have a working knowledge of this structured settlement option, and to make the client aware of it in appropriate cases.

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