Keeping the Spigot Open: Protecting Guaranteed Streams of Income

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National Elder Rights Training Project for the National Legal Resource Center.
Sponsorship for this Webinar is provided by the National Consumer Law Center,
and a grant from the Administration on Aging.

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Dec 19, 2012

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Presenter – Jay Sushelsky

- Senior Attorney with AARP Foundation Litigation in Washington, DC, where he practices in the areas of Employee Benefits Law and Investor Protection and Securities Law.
- Prior to joining AARP Foundation Litigation in 2005, Mr. Sushelsky was in private law practice in St. Louis, Missouri for twenty-five years.
- He is a graduate of Tufts University and Washington University School of Law.

Presenter – Stuart Rossman

- Staff attorney at the National Consumer Law Center and has served as its Director of Litigation since 1999.
- Stuart is the co-editor of the 7th Edition of the NCLC Consumer Class Actions manual and coordinates NCLC's Consumer Class Action Symposium.
- After 13 years of private trial practice in Boston, Stuart served as Chief of the Trial Division and Chief of the Business and Labor Protection Bureau at the Massachusetts Attorney General's Office from 1991-1999.
- Since 1992 he has been a member of the adjunct faculty at the Northeastern University School of Law where he teaches courses in Civil Trial Advocacy and is the 2010 Givelber Distinguished Lecturer on Public Interest Law. He also is a member of the adjunct faculty at the Suffolk University School of Law.

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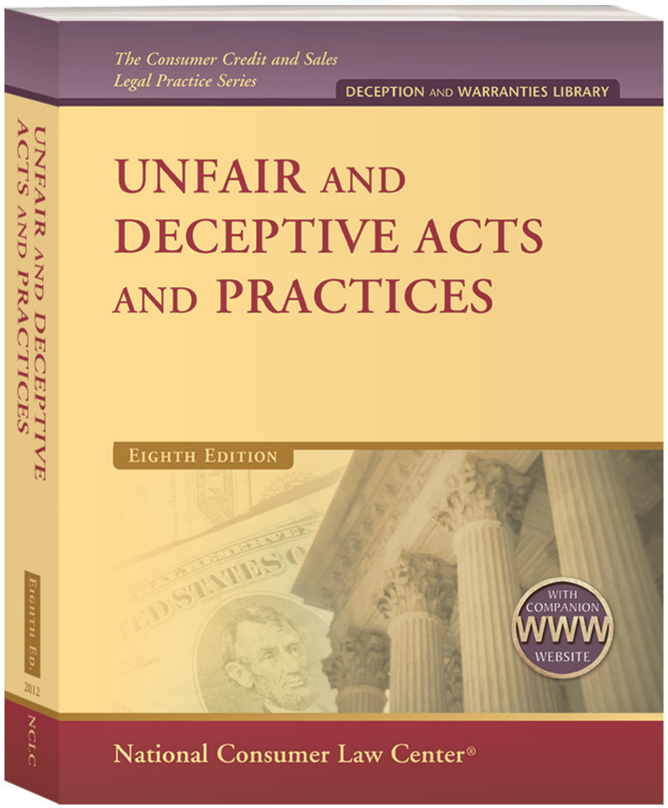
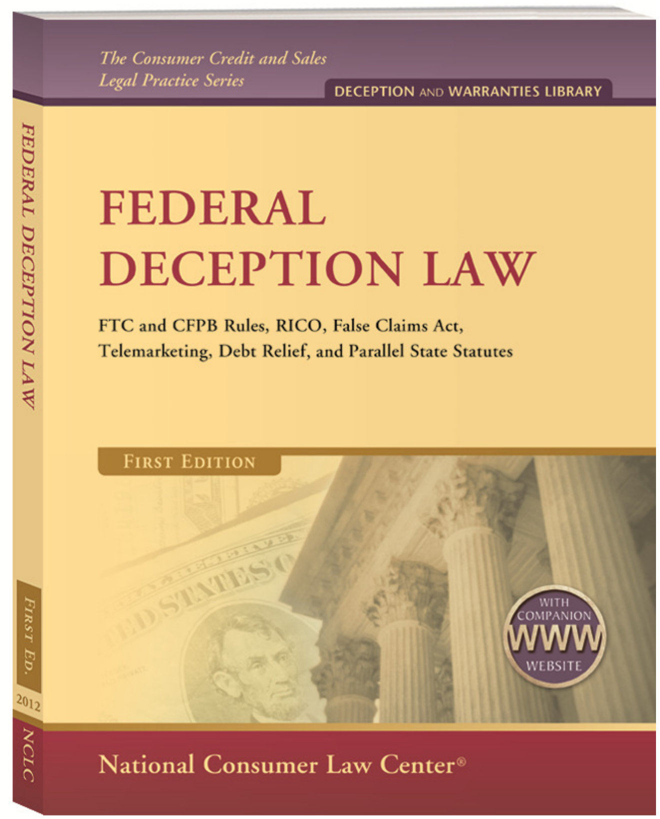
For More Information on Legal Remedies and Statutes to Protecting Guaranteed Streams of Income See these NCLC Manuals:





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Henry v. Structured Investments CO., L.L.C.

Superior Court for the State of California, County of Orange

Case No. 05CC00167

Complaint can be found at:

http://www.nclc.org/images/pdf/litigation/henry_complaint.pdf

Trial Ruling can be found at:

http://www.nclc.org/images/pdf/litigation/Henry.pdf

The Transaction

1) Veteran responds to SICO nationally distributed advertisements
2) Based upon the veteran's retirement or disability status, rank and pay grade upon retirment, SICO quotes a minimum and maximum lump sum amount it will provide
3) All terms of the Agreement are dictated by SICO

4) Veteran provides authorization to the DOD or VA to send (allotments) the veteran’s retirement or disability payments directly to an account controlled by SICO subject to a power of attorney provided by the veteran to SICO
5) Veteran is required to buy a life insurance policy covering the payments with the premium for the policy paid out of the initial SICO distribution and the policy is collaterally assigned to SICO

6) Agreement provides that SICO has a security interest in the veterans' military retirement or disability benefits
7) Agreement provides that the veteran's repayment obligation is increased from 96 months to 120 months if there is any disruption, interruption or decrease in those payments caused by the veteran

Claims

1) The provisions of the Agreements purporting to require plaintiff and class members, retired and disabled military veterans, to provide defendants direct access to military benefits are void and unenforceable attempts to circumvent the prohibition upon assignments of military benefits

2) Defendants may not enforce or collect any amount from plaintiff or class members beyond return of the principal of the loan, because the effective interest rates charged exceed the maximum permissible rate under the California usury law

Questions Presented

1) Are the Agreements between the parties illegal assignments under federal law?

2) If the Agreements are illegal assignments under federal law are they unlawful and unfair under the California Consumer Protection Statute (UCL)?

3) Are the Agreements loans?

4) If the Agreements are loans, are they usurious?

5) What relief, if any, is the class entitled to?

Title 37 U.S.C. § 701

(a) Under regulations prescribed by the Secretary of the military department concerned, a commissioned officer of the Army, Navy, Air Force, or Marine Corps may transfer or assign his pay account, when due and payable.

(c) An enlisted member of the Army, Navy, Air Force, or Marine Corps may not assign his pay, and if he does so, the assignment is void.

Title 38 U.S.C. § 5301

(a)(1) Payments of benefits due or to become due under any law administered by the Secretary shall not be assignable except to the extent specifically authorized by law…

(3)(A) This paragraph is intended to clarify that, in any case where a beneficiary entitled to compensation, pension, or dependency and indemnity compensation enters into an agreement with another person under which agreement such other person acquires for consideration the right to receive such benefit by payment of such compensation, [or] pension…including deposit into a joint account from which such other person may make withdrawals, or otherwise, such agreement shall be deemed to be an assignment and is prohibited.

(C) Any agreement or arrangement for collateral for security for an agreement that is prohibited under subparagraph (A) is also prohibited and is void from its inception.

Findings

1) The Agreements governed by 37 U.S.C. § 701(c) and 38 U.S.C. § 5301 are assignments

2) The assignments are unlawful and unfair and violate the California Consumer Protection Act (UCL)

3) “Because the defendant SICO used the unlawful Agreements to obtain the class members’ government benefits which the law meant to protect, and mischaracterized the true nature of the Agreements, the defendant’s ‘program’ constitutes a sharp practice and is unfair within the meaning of the UCL. The court finds the defendant’s practice is unscrupulous and substantially injurious to consumers in general and to the members of the class in particular. The court can find no lawful utility to SICO’s program of acquiring the pension payments of the class members though the use of its unlawful conduct.”

4) SICO is enjoined from using the Agreements

5) Plaintiff and the class are entitled to restitution in the amount SICO collected from the class members in excess of the “Lump Sum” payment within the statutory period in the sum of $2,927,619.81

6) The court’s finding that the Agreements are assignments would be inconsistent with a finding that the Agreements are loans and, therefore, dismisses the usury claims

Protecting Guaranteed Streams of Income:

Pension Benefits, Derisking, and Structured Settlements

JAY E. SUSHELSKY, SENIOR ATTORNEY

ALISON FALB, LEGAL FELLOW

AARP FOUNDATION LITIGATION

Introduction

- Lump sum payments for pensions
- Derisking
- Lump sum payments for personal injury settlements

Exchanging Lump Sums for Pension Benefits

ERISA's Anti-alienation Provision: Section 206(d)

(1) Each pension plan shall provide that **benefits provided under the plan may not be assigned or alienated**.

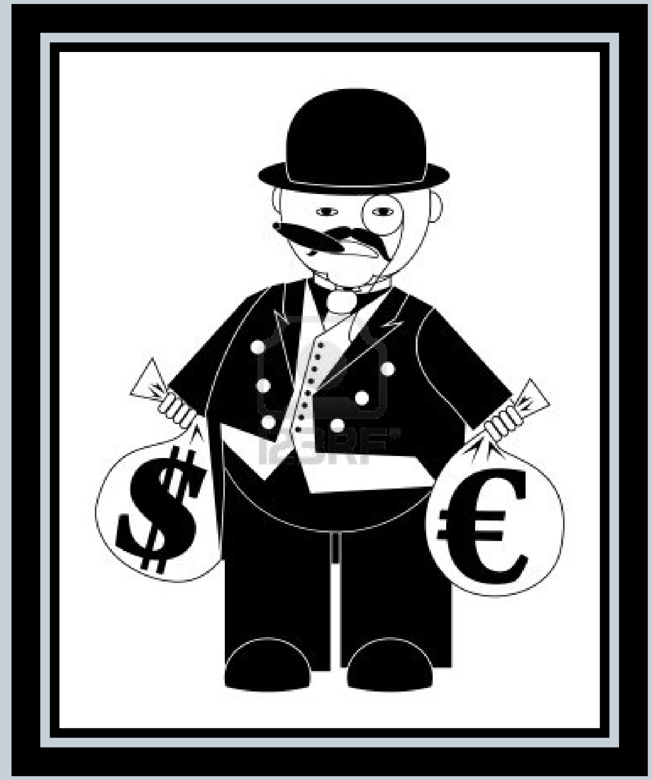
- For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 of the Internal Revenue Code of 1986 [26 USCS § 4975] (relating to tax on prohibited transactions) by reason of section 4975(d)(1) of such Code [26 USCS § 4975(d)(1)].
- <u>Preemption</u>: ERISA assignment-alienation prohibition preempts otherwise relevant state law as is applies to claims by commercial creditors in non-bankruptcy situations against ERISA-qualified benefit plans. Citizens Bank of Ashburn v Shingler (1985) 173 Ga App 511, 326 SE2d 861.

The Rationale Behind ERISA's Anti-Alienation Provision

- The purpose of the provision is to ensure that participants have their retirement funds available during retirement.
  - The purpose is **to prevent plan participants from recklessly divesting themselves of plan benefits before retirement.** Boggs v Boggs (1996, CA5 La) 82 F3d 90.
  - Purpose of general prohibition against transfers of pension benefits governed by ERISA is **to ensure that employee's accrued benefits are actually available for retirement purposes**, but stated purpose does not mean that all claims against pension benefits are considered same. Biles v Biles (1978, Ch Div) 163 NJ Super 49, 394 A2d 153, 1 EBC 1348.
  - ERISA's anti-alienation provision is designed **to advance important public policy of insuring that employee's accrued benefits are actually available for retirement purposes**. Ward v Ward (1978, Ch Div) 164 NJ Super 354, 396 A2d 365, 1 EBC 1360.

Clear Violations of ERISA and the Extent of its Protections

<u>Clear violation:</u>
When the plan is involved in the transaction.
For example, if the plan pays the creditor directly.



The Extent of ERISA's Protections

- The anti-alienation provision does not protect benefits once they are received by the recipient.
  - Benefits are protected by anti-alienation provision as long as they are within fiduciary responsibility of private plan managers; following distribution of benefits to plan participant or beneficiary, such protection ceases. Corzin v Larson (In re Larson) (2006, BC ND Ohio) 340 BR 852.
  - **Terms "assignment" and "alienation" in the anti-alienation provision are meant only to cover those arrangements that generate rights enforceable against ERISA plans**, so that benefits are protected by antialienation provision only so long as they are within fiduciary responsibility of private plan managers. Guidry v Sheet Metal Workers Nat'l Pension Fund (1994, CA10 Colo) 39 F3d 1078.

The Extent of ERISA's Protections

- The anti-alienation provision **protects benefits only while they are held by plan administrator and not after they reach hands of beneficiary.** Robbins v DeBuono (2000, CA2 NY) 218 F3d 197.
- ERISA's anti-alienation provision protects pension funds in form of check made payable to plan participant but not yet transferred to participant. Shinehouse v Guerin (1997, CA3 Pa) 20 EBC 2422.
- Where court enforced plaintiff's judgment by ordering defendant to deposit income into bank account, including defendant's Employee Retirement Income Security Act (ERISA) monthly pension benefits, order did not violate ERISA's anti-alienation provision, 29 USCS § 1056(d)(1), because § 1056(d)(1) applies to benefits only while held by plan administrator and not after they reach hands of beneficiary. Hoult v Hoult (2004, CA1 Mass) 373 F3d 47.

The Extent of ERISA's Protections

- Be aware of what constitutes benefits for purposes of the anti-alienation provision
  - Undistributed funds held in trust for members of defined contribution pension plan do not constitute "benefits" within meaning of anti-alienation provisions, and **anti-alienation rule does not prevent pension plan assets from being used to satisfy judicial judgment that has been entered against plan itself; Employee Retirement Income Security Act's prohibition on alienation does not impair plan's ability to pay its own debts**. Milgram v Orthopedic Assocs. Defined Contribution Pension Plan (2011, CA2) 666 F3d 68.

Predatory Practices That Do Not Violate ERISA

- **Agreements between the entitlement holder and a third party when plan is no longer involved may take advantage of the beneficiary and leave them poorly situated for retirement.**
  - The anti-alienation provision applies only to actions against plan, not to actions against beneficiary; thus, funds that have been distributed to beneficiary are not protected by anti-alienation provision. Trucking Employees of N. Jersey Welfare Fund v Colville (1994, CA3 NJ) 16 F3d 52, 17 EBC 2249.
  - The anti-alienation provision does not prohibit garnishment of pension benefits after benefits have been paid to and received by beneficiary. Guidry v Sheet Metal Workers Nat'l Pension Fund (1994, CA10 Colo) 39 F3d 1078.
  - Assignment or alienation of pension benefits that have actually been distributed under plan is not prohibited. Wright v Riveland (2000, CA9 Wash) 219 F3d 905, 2000 CDOS 5681, 2000 Daily Journal DAR 7551, 24 EBC 2225.
  - Once benefits of ERISA employee welfare benefit plan have been distributed according to plan documents, ERISA does not preempt imposition of constructive trust on those benefits. Central States, Southeast & Southwest Areas Pension Fund v Howell (2000, CA6 Ohio) 227 F3d 672.
  - Under the anti-alienation provision, only once proceeds of pension plan have been released to beneficiary's hands can creditors and others pursue claims against funds and funds' owners. United States v All Funds Distributed to Weiss (2003, CA2 NY) 345 F3d 49, 31 EBC 1134.sh

Derisking

- A LEGAL WAY FOR PLANS TO PROVIDE A LUMP SUM IN LIEU OF A GUARANTEED STREAM OF INCOME
- A TREND THAT MULTIPLE LARGE COMPANIES ARE CURRENTLY PURSUING

Derisking

- What is Derisking?
  - Offering lump sum pension payments to retirees and former employees in lieu of an annuity or periodic payment. If the individual elects to receive this payment, the company no longer has a pension obligation to the individual.

Why Derisk? Who is Derisking?

- **Why is Derisking Attractive to Employers?**
  - It reduces their pension obligations
  - It lets them avoid the volatility of pension management
  - It takes pension liabilities off their balance sheets
  - It helps support profitable growth strategies
  - Depending on the interest rate landscape it may make sense financially
- **Derisking in the News:**
  - Various large corporations such as Ford, JC Penney, and GM are derisking.

Why Might a Beneficiary Choose to Accept a Lump Sum?

- Reasons a retiree might choose a lump sum:
  - They may consider Social Security to be a sufficient source of annuity income
  - Flexibility: can be used for large expenditures such as health care costs
  - Participants may want to have a lump sum available to will to heirs and charities
  - Participants may not understand annuities and longevity risk and may therefore overvalue a lump sum

Beneficiary Vulnerability Issues and Derisking

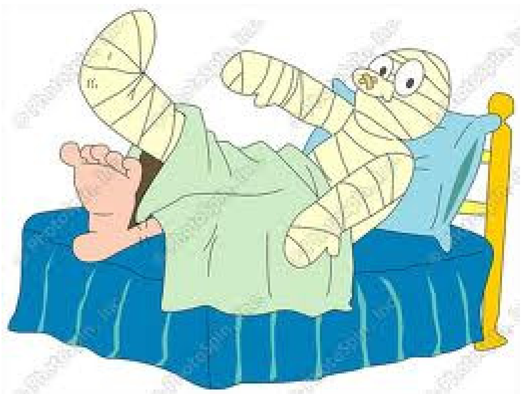
- **Derisking is not a predatory practice**. It is perfectly legitimate under ERISA, the IRC, and state law.
- However, derisking or transforming annuity income into a lump sum may create a vulnerable status because beneficiaries may be exploited for their lump sum.
- Predatory lenders may take advantage of a retiree who has just received a large amount of money.
- It is therefore important to consider how best to advise a client who receives a lump sum so that they plan adequately for their future.

What Should a Lawyer Consider to Advise a Client about Derisking?

- General Questions:
  - What are the tax consequences?
  - What are the terms of the transaction?
- If the client accepts the lump sum:
  - Who should manage the lump sum?
  - Does the client want an annuity?
    - What are the annuity fees?
    - How creditworthy is the annuity provider?

Lump Sums For Personal Injury Settlements

THERE ARE NUMEROUS ENTITIES WILLING TO PURCHASE A STREAM OF PAYMENTS FROM A STRUCTURED SETTLEMENT, SUCH AS A PERSONAL INJURY SETTLEMENT.



Sale of the Rights to Structured Settlement Payments: How is the Lump Sum Calculated?

- <u>Calculation of "net present value" or NPV</u>
  - Current value of future payment.

- <u>Purchase options:</u>
  - Full purchase – the purchaser commonly calculates NPV of the payments and offers a lump sum, usually substantially less than the total initial amount or even the NPV
  - Purchase of a specific number of payments – only a specific number of the future payments are purchased at a discounted NPV rate
  - Purchase of a portion of each payment – the purchaser acquires only a right to a certain percentage of each payment, with the balance to the original recipients

Risk of Predatory Transactions With Personal Injury Settlements

- A cash buyout undermines the intent of the structured settlement to create stability and take care of the plaintiff.
- Risk of depletion:
  - AIG American General Survey, http://www.aigag.com/life/life.nsf/Lookup/AIGSSsurvey_press/$file/AIGSSsurvey_report.pdf)
  - Of Respondents to survey who took the lump sum option, 57% reported that the entire settlement is depleted
  - An additional 10% stated that less than 25% remained.
- The terms of these agreements frequently result in a large loss of money by the seller.
  - Companies charge significant fees ranging from 21 to 70 percent of the total value of the settlement.
- Tax consequences
  - There is a tax exemption for personal injury structured settlements, but earnings on a lump sum are taxable.
- The predatory practices of these lenders leave many people surrendering much of the settlement without fully recognizing the tradeoffs.

Which plaintiffs are most likely to win structured settlement payments?

- Usually structured settlement cases involve significant life changing injuries or the death of a primary financial provider.
- Structured settlements are used most often where the injured party may
  - Be permanently disabled from employment
  - Require future medical treatment, or
  - Require long term care.
  - Be a minor child.
- By spacing payments over time, such agreements ensure that money for medical care is available as it becomes necessary.
  - The structured settlement may pay for college or replace long-term lost wages with regular payments that can be used to meet care needs and/or household expenses.
  - Incremental nature of the payments is a financial planning device.

Legal Procedures Necessary for Sale of Structured Settlements

- <u>State Law</u>
  - Structured settlement payment law: Most states have laws that regulate the purchase of the right to structured settlement payments. These laws commonly require, among other things, specific, written disclosures regarding the transaction, such as fees, commissions, and discount rates, and also require court approval prior to the actual sale.
- <u>State consumer protection law: Unconscionability</u>
  - Wiggins v. Peachtree Settlement Funding (In re Wiggins), 273 B.R. 839 (Bankr. D. Idaho 2001).
    - As a result of an automobile accident at the age of 16, the debtor received structured settlement and annuity payments. Subsequently, the company, which purchased structured personal injury and other settlement payment streams for cash at what the company considered their discounted present value and then resold the settlements or annuities for a profit, offered to purchase the debtor's right to receive monthly payments and one lump sum payment. The court concluded that the transaction and the company's conduct was unconscionable. The court concluded that the company's conduct amounted to a breach of fiduciary duty, constructive fraud, and violated numerous provisions of the Idaho Consumer Protection Act.
  - Stone St. Servs. v. Daniels, 2000 U.S. Dist. LEXIS 18904 (E.D. Pa. Dec. 29, 2000)
    - Court held unconscionable a company's taking advantage of annuity recipient's diminished mental capacity and dealing with his brother-in-law while knowing he was not the appropriate legal representative.

Federal Regulation of Structured Settlement Purchases

- Federal Law
  - Victims of Terrorism Relief Act of 2001: Congress enacted a law applicable to the sale of structured settlements (the Act). 26 USC §5891.
    - The Act requires that all sales, assignments, transfers, or encumbrances (i.e., borrowing money secured by the settlement payments) of structured settlements be approved by a state court.
    - The Act does not mandate the procedure, but requires states to evaluate whether the sale is in the best interests of the seller, taking into account the welfare and support of the seller's dependents, and violates no federal or state law or court order.
    - Once the court has determined that the sale qualifies, it must issue a "qualified order" approving the transfer or sale. – In addition, a "model act" intended to regulate such sales, has been adopted by most states.
    - Failure to Comply With the Act
      - **If the parties fail to obtain a "qualified order," the Act imposes on "any person who acquires directly or indirectly structured settlement payment rights in a structured settlement factoring transaction a tax equal to 40 percent of the factoring discount." The "factoring discount" is an amount equal to the difference between: The gross total, undiscounted sum of the payments purchased minus the total amount actually paid by the purchaser**
- The Consumer Finance Protection Bureau
  - http://www.consumerfinance.gov/
- Unfair, Deceptive or Abusive Acts or Practices (UDAAP)

Questions?

IF YOU HAVE FURTHER QUESTIONS, YOU MAY CONTACT

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