Legal Aid Society
OF THE DISTRICT OF COLUMBIA
MAKING JUSTICE REAL

Before the Committee on the Judiciary & Public Safety
Council of the District of Columbia

Hearing on Bill 22-0020,
The Consumer Disclosure Act of 2017

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Title I of Bill 22-0020 is a structured settlement protection law for the District of Columbia. Structured settlements, which are often used in the settlement of personal injury actions, provide for injured persons (or their dependents) to receive periodic payments under annuity insurance contracts, often long into the future. But many such persons eventually sell their rights to the future payments to purchasers known as "factoring companies." Why? Because those companies, using television and internet advertising and identifying settlements through court records, offer holders of structured settlement annuities immediate cash at heavily discounted rates in exchange for the right to receive the future payments.

Thankfully, federal law requires that companies seeking to purchase rights to structured settlement payments first obtain approval of a state court, which must find that the transfer is in the payee's "best interest."[1] Forty-nine states have enacted Structured Settlement Protection Acts (SSPAs) implementing that requirement and providing additional protections for payees, who often do not understand the legal and financial implications of the transfer. Because the District has not enacted an SSPA, when a D.C. resident seeks approval of a proposed transfer, the D.C. Superior Court must apply the law of the state where the annuity issuer is domiciled. The absence of a D.C. SSPA also means that the transferee can (and sometimes does) elect to file the request for state court approval of a D.C. resident's transfer in the state of the annuity issuer's domicile. For these reasons alone, the District urgently needs its own SSPA.

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[1] For purposes of structured settlement protection laws, the person receiving payments under a structured settlement is referred to as the "payee." The sale of rights to the future payments is referred to as a "transfer." The party purchasing the rights is referred to as a "transferee." And the insurance company making the payments is referred to as an "annuity issuer."

The Legal Aid Society of the District of Columbia[2] (Legal Aid) regularly provides independent professional advice and representation to low-income District residents who have agreed to transfer their rights to some or all of their structured settlement payments to a factoring company. We strongly support the enactment of this proposed legislation, but urge the Council: (1) to consider using the model SSPA supported by the two key industry stakeholders as a baseline; and (2) to add additional consumer protection provisions (discussed in greater detail below) that would strengthen the bill and tailor it to the needs of D.C. residents and the D.C. courts. Enactment of these additional protections will ensure that the structured settlement protection law applied by the Superior Court contains the features needed to protect D.C. residents from ill-advised transfers for too little cash.

A. Background

Structured settlements of personal injury and wrongful death actions came into vogue in the 1970s. They facilitate settlements by providing for future periodic payments in amounts far greater than the cost of the insurance contract that funds the settlement. Even more important, structured settlements protect persons likely to have difficulty managing and conserving a large lump sum settlement amount (the principal alternative to a structured settlement).

Not long after structured settlement became commonplace, factoring companies began offering cash to structured settlement payees in exchange for transfer of their rights to some or all of the future payments.[3] After a period of legal uncertainty regarding the validity of these transfers and their tax consequences,[4] Congress enacted a federal tax code provision that imposes a heavy excise tax on the transferee factoring company unless it obtains a "qualified order" from a state court judge approving the transfer. 28 U.S.C. § 5891 (titled "Structured settlement factoring transactions"). To approve the transfer, the court must find that the transfer is in the "best interest" of the payee (taking

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[2] The Legal Aid Society of the District of Columbia is D.C.'s oldest and largest general civil legal services organization. Since 1932, Legal Aid lawyers have been making justice real in individual and systemic ways for persons living in poverty in the District. Legal Aid's Consumer Law Unit has been providing independent professional advice and representation to District residents seeking to transfer rights to structured settlement payments since 2013.

[3] In one long-running late night television commercial, a large factoring company trumpeted: "If you've got a structured settlement, we've got cash!"

[4] Under current federal tax law, damages received for physical injuries are tax free, as are the future payments under a structured settlement and cash paid for the future payments in an approved transfer of rights.

into account the welfare and support of the payee's dependents), and does not "contravene any Federal or State statute or the order of any court."[5] *Id.* § 5891(b).

Even before the federal law was enacted, the two principal industry stakeholders – the insurance companies issuing the annuities supporting structured settlements and the factoring companies regularly purchasing rights to future structured settlement payments – collaborated on a model Structured Settlement Protection Act. The model state act is designed to provide basic protections to payees while also protecting other interested parties from conflicting claims to the future payments. Today that model act is sponsored by the National Conference of Insurance Legislators (NCOIL). As more and more states adopted versions of the model that incorporated payee protection features not in the model, the NCOIL Model was updated (most recently in November 2016) to add a few of those features.

The model act, however, reflects a compromise between differing interests of the insurance companies (who are more likely to support provisions designed to minimize subsequent payee challenges to the validity of approved challenges) and purchasers (who are less likely to support payee protection features that they view as making it too difficult to obtain qualified orders). In the face of that lowest common denominator compromise, and due to well publicized factoring company abuses, many states have concluded that their SSPAs should incorporate stronger protections for payees than those in the model. As explained below, Legal Aid believes that D.C.'s SSPA should provide such enhanced protections.

B. Conforming Title I of the Bill to the NCOIL Model SSPA

Title I of Bill 22-0020 would create a structured settlement protection law for the District consistent with the federal tax code provision. Although the introduced version of Title I uses much of the structure and language of the NCOIL Model, it does not incorporate the latest amendments to the model and contains some significant departures from the model. The two principal industry stakeholders – the National Structured Settlements Trade Association (NSSTA, which represents the insurer interests) and the National Association of Settlement Purchasers (NASP, which represents purchaser

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[5] The tax code provision requires that a court of the state of domicile of the payee issue the order approving the transfer, unless that state does not have an implementing statute. *See* 28 U.C.C. § 5891(b)-(c). In that case, either a court of the state in which the annuity issuer is domiciled or a court in the state in which the payee is domiciled may hear the case. If the case is heard by a court in a state that does not have an implementing statute, the court applies the law of the state where the annuity issuer is domiciled. (The District is a state for purposes of the tax code.) In the absence of a D.C. SSPA, the D.C. Superior Court must apply another state's law in every structured settlement transfer case filed here. Some judges of the court have questioned the court's jurisdiction to hear these cases in the absence of an authorizing D.C. statute.

interests) – have proposed that the Committee conform Title I of B22-0020 to the 2016 version of the NCOIL Model.

Legal Aid agrees that the current NCOIL Model provides an appropriate baseline for a D.C. SSPA. Adoption of the core features of the current model act would promote uniformity among the states and provide for consensus among stakeholders on baseline language and certain consumer protection features already incorporated in the model. If the Committee decides to conform Title I of the bill to the NCOIL Model in light of the broad stakeholder consensus, however, Legal Aid believes that the Committee should further amend the conformed title to include enhanced protections for D.C.-resident payees. We also would retain a version of most of the payee protection features from B22-0020 that are not in the model. These features include language that would help ensure that independent professional advisers providing advice to payees are truly independent of the purchaser and without conflicts of interest and a provision requiring the court to consider whether the terms of the transfer are fair and reasonable. There is no corresponding language in the NCOIL Model.

Attached to this testimony as Exhibit 1 is a copy of the bill conformed to the NCOIL Model SSPA (in the form transmitted to the Committee by NSSTA and NASP), with redlining showing the further amendments that Legal Aid urges the Council to make in order to protect D.C.-resident payees.

C. Legal Aid's Proposed Amendments to the NCOIL Model SSPA

Each of Legal Aid's proposed amendments to the NCOIL Model SSPA is identified and explained below.

1. Section 101(6) (Definition of "independent professional advice"): The model act as adopted in virtually all states gives payees the right to obtain independent professional advice from an attorney, certified public accountant, actuary, or other licensed professional adviser before moving forward with a transfer of structured settlement annuity rights. Such advice helps a payee, who may be unsophisticated about these matters, to understand the legal, tax, and financial implications of the transfer and whether the transfer is truly in his or her best interest, all things considered.

In Legal Aid's experience, payees often do not understand the enormous financial price they must pay to "cash out" a portion of their annuity or even that the amount to be paid for future payments is negotiable. In addition to addressing those matters, independent professional advisers also can assist payees in exploring whether there are reasonable alternatives for meeting their stated needs for the cash. Further, the independent adviser can assess whether the transfer could be restructured to retain more of the future payments while still meeting the payee's short term needs.

But the right to receive independent professional advice is worthless if the professional advice does not come from a truly independent adviser. In some jurisdictions, unscrupulous factoring companies refer their payee customers to affiliated attorneys who are paid by the transferee or whose compensation is affected by whether or not the transfer is approved.

The model act defines "independent professional advice" as "the advice of an attorney, certified public accountant, actuary, or other licensed professional adviser." Title I of the bill, as introduced, enhanced two aspects of this definition. First, it addressed the independence problem by adding language to this definition to further define the "adviser" as someone who is not affiliated with or compensated by the transferee and does not have a compensation arrangement affected by whether the transfer occurs. Second, the bill's language also made clear that the independent adviser is retained to address the "legal, tax, and financial implications of a transfer of structured settlement payment rights." Legal Aid supports the bill's enhancements and would retain the original bill language in section 101(6) of conformed Title I.

2. Section 102 (Additional considerations for approval of transfers of structured settlement payment rights): This section identifies the requirements for the court's approval of a transfer of structured settlement payments rights. The NCOIL Model requires the court to make three express findings: (1) that the transfer is in the best interest of the payee (considering the welfare and support of the payee's dependents); (2) that the transfer does not contravene any applicable statute or court order; and (3) that the payee has been advised in writing to seek independent professional advice or has waived that opportunity in writing. (The first two findings are required by the federal tax code provision.)

Many states that have enacted an SSPA based on the NCOIL Model have supplemented this provision to require the court to make additional findings or to consider certain information in making the best interest finding. Legal Aid believes that the District's SSPA should identify additional relevant information that the court must consider before making the best interest finding. The introduced bill took that approach as well.

We propose that the court be required to consider the following additional matters:

> (1) Whether the payee understands the terms and financial implications of the transfer;
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> (2) Whether the financial terms of the transfer are fair and reasonable to the payee;

(3) The payee's stated needs for the funds to be obtained from the transfer and whether there are reasonable alternatives to meeting those needs; and

(4) The recurring and lump sum payments included in the structured settlement at the time it was established, the history of prior transfers and attempted transfers, and the recurring and future lump sum payment amounts that remain payable to the payee.

In advising payees, Legal Aid has found that each of these matters is critical to understanding the implications of the proposed transfer and highly relevant to an informed consideration of whether the transfer is truly in the payee's best interest.

As introduced, Section 102 of the bill contained a provision similar to our proposed (2) above. We have refined the original language to focus the reasonableness question on the *financial* terms of the transfer and the reasonableness of those terms to the *payee*.

The introduced bill also contained a requirement that the court find that "[t]he payee *has received* independent professional advice regarding the legal, tax, and financial implications of the transfer." B22-0020, sec. 102(4) (emphasis added). That is, the bill would not allow a payee to waive the right to receive independent professional and would instead require actual receipt of such advice as a condition of court approval. Legal Aid does not support a requirement that the payee actually have obtained independent professional advice. For low and moderate income District residents who are unable to secure free professional advice through a legal services provider or pro bono lawyer,[6] such a requirement would either effectively bar them from obtaining a transfer or, more likely, would lead purchasers to refer payees to advisers who have a business relationship with the purchaser or who are compensated by the purchaser. The amended bill, as conformed to the model act, would require the court to find that the transferee has advised the payee in writing to seek independent professional advice and has either received that advice or knowingly waived in writing the opportunity to do so.

3. Section 103 (Required disclosures to payee): This section addresses required disclosures to the payee. The NCOIL Model requires that the disclosures be provided to the payee in writing no less than 3 days before the payee signs a transfer agreement. The bill language was similar. Legal Aid believes that a 3-day period is much too short, because it does not afford the payee a meaningful opportunity to obtain independent professional advice after receiving the disclosures and before signing the agreement. We propose that the disclosures be provided no less than 10 days before the

[6] Some judges of the Superior Court regularly refer structured settlement payees to Legal Aid after transfer cases are filed.

payee signs a transfer agreement. A 10-day period is also consistent with actual practice of the transferees who regularly file transfer cases in the District.

Next, Legal Aid would modify the required disclosure concerning rights of cancellation. Subsection 103(9) of the NCOIL Model gives the payee a right to cancel the transfer agreement without penalty or further obligation not later than the third business day after the payee signs the agreement. Legal Aid would amend that provision to allow for cancellation "at any time prior to entry of a final court order approving the transfer."

As a practical matter, no transfer can go forward without court approval and the court is not likely to find that the transfer is in the best interests of a transferee who no longer wants to transfer payment rights. Further, all of the major purchasers who regularly file transfer petitions in the District already give their payees a much longer cancellation period: five business days *after* they actually receive the funds following court approval. A longer cancellation period will protect D.C. residents from less scrupulous purchasers who may attempt to use the signed agreement to coerce a reluctant payee into going forward with the transfer even after changing her mind.

Legal Aid also would add an additional disclosure to those required by the model act or included in the introduced bill. Payees often accept the first offer made by the purchaser, not realizing that the amount to be paid is negotiable and that a higher amount is often available for the asking. In our experience, the financial terms initially offered by purchasers are patently unreasonable in virtually every case. Although even the best available terms always result in a payment amount considerably less than the true present value of the future payments, a payee who obtains competing quotes or negotiates can almost always obtain better terms. For these reasons, we would add the following to the list of required disclosures in Section 103:

> (10) That the amount to be paid for the structured settlement payments is negotiable, that the payee may ask the transferee for an amount greater than the amount offered by the transferee, and that the payee may request competing quotes from other potential transferees.

4. Section 104 (Information regarding prior transfers and proposed transfers): This section addresses the court procedure for approvals of transfers. Among other things, it lists the documents and information that must be included in the initial filing with the court and served on interested parties. The latest amendments to the NCOIL Model require that this information include a summary of the payee's prior transfers and proposed transfers, both transfers involving the current transferee and transfers involving other transferees. Unfortunately, the provision adding this important new informational requirement is time-limited. For example, it requires disclosure of denials only within the past two years (for the current transferee) or within the past year

(for other transferees). For approvals, the time limits are the past four years (for the current transferee) or three years (for other transferees).

Legal Aid believes that everyone involved in the process – the payee, the independent professional adviser, the transferee, and, importantly, the court – needs a complete picture of all prior transfers and denied transfers. This information provides important context for the ultimate best interest question and ensures that interested parties and the court are on the same page regarding what future payments already have been transferred and what future payments remain. We therefore propose deleting all time limitations from the Model Act provision requiring that information about past transfers be provided to the court. Recognizing that in some cases it may not be possible for a transferee to obtain older information regarding transfers to a different transferee, however, we have limited the obligation to information that is actually disclosed or known to the current transferee or is "reasonably obtainable" from other sources, including court records.

D. Conclusion

Legal Aid commends the bill sponsors – Councilmembers Cheh, Bonds, and Grosso – for re-introducing the Consumer Disclosure Act in this Council session and the Committee for its expeditious scheduling of a hearing on Bill B22-0020.

We urge the Committee to conform Title I of the bill to the NCOIL Model as proposed by the industry stakeholders, but also to adopt the amendments to that model act identified in this testimony and in the attached redline of the model. We also urge the Committee to move the bill to markup and final Council action as soon as possible due to the urgent need for this long overdue legislation.

Thank you for the opportunity to testify.