HOUSE OF REPRESENTATIVES
COMMONWEALTH OF PENNSYLVANIA

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House Bill 825 & Senate Bill 818

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House Judiciary Subcommittee on Courts

Greater Philadelphia Chamber of Commerce
Conference Room, Seventh Floor
200 South Broad Street
Philadelphia, Pennsylvania

Monday, July 19, 1999 - 9:15 a.m.

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BEFORE:

Honorable Daniel Clark, Majority Chairperson
Honorable Lita Indzel Cohen
Honorable Frank Dermody, Minority Chairperson
Honorable Craig Dally

IN ATTENDANCE:

Honorable Thomas Gannon
Honorable Timothy Hennessey
Honorable Nicholas Micozzie
Honorable Harold James
Honorable Babette Josephs
Honorable Chris Ross
Honorable Don Walko
Honorable LeAnna Washington

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ALSO PRESENT:

Brian Preski, Esquire
Majority Chief Counsel

Beryl Kuhr, Esquire
Minority Counsel

CONTENTS

(Written testimony was submitted on behalf of Douglas Yauger, Chief Deputy Attorney General, Bureau of Consumer Protection)

CHAIRPERSON CLARK: Good morning. I'd like to thank everybody for coming out this morning. This is the Pennsylvania House of Representatives Judiciary Committee, Subcommittee on Courts hearing on House Bill 825 and it's companion Senate Bill 818.

This is the time and place advertised for the public hearing on the Subcommittee on Courts. I am the chairman of that subcommittee. I'm Representative Dan Clark. I'd like the rest of the members to introduce themselves to you, along with staff. I'll start over here to my left.

REPRESENTATIVE JOSEPHS: Thank you. I'm Babette Josephs. Welcome everybody to the 182nd District.

REPRESENTATIVE COHEN: Lita Cohen, 148th District, Montgomery County, adjacent to Philadelphia.

REPRESENTATIVE DERMODY: Frank Dermody, Allegheny County.

REPRESENTATIVE DALLY: Craig Dally. 138th District, Northampton and Monroe Counties.

REPRESENTATIVE ROSS: Chris Ross from Chester County.

REPRESENTATIVE HENNESSEY: Tim Hennessey from Chester County.

MS. KUHR: Beryl Kuhr, Democratic counsel to the committee.

CHAIRPERSON CLARK: The first individual to provide testimony this morning is Sam Marshall, Esquire. He is the president of the Insurance Federation of Pennsylvania. You may proceed.

MR. MARSHALL: Good morning. Thank you for the opportunity to be here. I'm Sam Marshall, president of the federation. We are a nonprofit trade association representing insurance companies of all sizes and shapes in Pennsylvania. Among our members are insurers that use structured settlements to settle personal injury and workers' compensation claims, as well as insurers that write the annuities used to fund these structured settlements.

I am here to speak in favor of structured settlement protection generally and the protections in Sentate Bill 818 specifically. This may be a bit more basic than some of you may need, but I'd like to start at the beginning.

What are structured settlements? Very simply, they're extended periodic payments used to pay personal injury and workers' compensation claims. They're generally funded through annuities so as to guarantee that the money promised at the time of the settlement is there when the payments are due, and to take advantage of federal tax policy that encourages the use of structured settlements to pay these kind of claims.

Second question, what are factoring companies? Factoring companies are entities that solicit claimants of structured settlements by offering cash for future payments. They offer the claimants cash in exchange for the claimants signing over to them the periodic payments of the annuities.

None of that changes the amount that the insurer pays through the annuity; just location of where the annuity payments go. These transactions are essentially transfers for money of the annuity payment.

A third question, why do we need a law to cover these factoring transactions? We need a law to protect both the consumers being solicited by factoring companies and the insurers funding the structured settlements that these companies are buying.

I know. Since when do insurance companies want laws to protect consumers? That sounds good because it panders to a lot of perceptions people have about insurers. But the reality is, we accept extensive regulation of the insurance industry that's designed to ensure that we deal fairly with consumers.

That's why the Insurance Department audits our marketing and claims practices. That's why we have laws like the Unfair Insurance Practices Act, and that's why we have a special bad faith statute that applies to insurers in dealing with their insureds.

Factoring companies, on the other hand, operate without any parameters. They're pushing pretty complex financial transactions. Take a look at a factoring company's purchase agreement. They are doing that without any disclosures or protections for consumers, and without any regulation or judicial oversight.

Now, for consumers, the problem is

one of knowledge and disclosure. They need to know the true terms of the deal.

The factoring companies say they are performing a valuable service for consumers. They try to portray the consumer problem as one created by insurers and trial lawyers, with factoring companies the protectors of consumers who have gotten into bad settlements. They try to portray any meaningful regulation of their conduct as anti-consumer.

Don't be deceived. The consumer problem here is a real one. Attached to my testimony is the January article from the U.S. News and World Report. It chronicles the consumer abuses that have been happening. Consumer protection is needed here, not to put factoring companies out of business--There are needed and legitimate factoring transactions--but to make sure that the transactions are fair ones.

For insurers, the concern is mainly one of tax liability. These factoring transactions create potential tax liabilities for the insurers who fund the structured settlements.

We need protection from that. Of course, protecting insurers here also protects the viability of structured settlements, which is good for consumers. If we don't have protection from tax liabilities, we simply can't offer structured settlements, or we're going to have to reduce the amount to cover that potential liability.

Then why do we need the protections that are in Senate Bill 818? I'll refer to that bill because that is the one that was amended with the Attorney General's amendments, the banking department's amendments, various entities, and then passed the Senate.

The bill meets the needs of consumers. It meets the needs of insurers, and it still allows for legitimate factoring transactions.

What does it do? First, it requires court approval of any buyout with the claimant required to get independent legal advice. This matches the requirement Pennsylvania has for lottery winners looking to sell their annuities. It seems incongruous to me that we would give greater protection and scrutiny to lottery winners than to those who have been injured.

Second, the bill requires full disclosure of the value and the essential terms of any buyout. These are similar to those that are required of insurers and banks when they enter into complicated financial transactions with consumers.

Third, the bill requires a financial hardship showing. That answers the tax problems raised by the Treasury Department. In fact, the hardship language in the bill matches that in the Treasury Department's proposed legislation, and the bill provides that if a different federal standard is ultimately enacted, that language is going to apply. The hardship standard still recognizes that a claimant's needs may change, and it allows that change to be addressed by a knowledgeable and needed cashing out.

Fourth, the bill requires the consent of the insurers that are parties to the structured settlements, but only if the transfer upends the terms of the structured settlement. It also says that insurers can't unreasonably withhold consent, and that consent isn't even needed once a tax issue goes away; once there's a favorable tax ruling in place.

What's the controversy about this bill? Frankly, I don't think there is a real controversy here, at least not when you look at the broad coalition that supports the bill. Obviously, the Insurance Federation does, and so do all of our national counterparts in both the property casualty and the life insurer annuity issuing stock, but look at the other groups.

The Pennsylvania Trial Lawyers Association supports the bill. That's the group that represents the consumers who enter into structured settlements. The Attorney General supports the bill. In fact, he came up with amendments in the Senate that strengthened it. The Ridge Administration has taken a not-oppose stance. Obviously, we were in touch with them and I'm sure others are, but they have a voucher issue going on in the spring and I think that took a little bit of their time.

The Hospital Association supports the bill. They see it as helping to protect victims who use structured settlements to resolve medical malpractice claims.

Groups representing the disabled community support the bill. You will hear later today from Tom Countee, who's the Executive Director of the National Spinal Cord Injury Association. He'll talk at more length on that, but that's an example of the disability community's views on this.

So, do consumer groups support the bill? At least they support the reforms that actually make reforms more onerous than those in the bill. Those groups include the Consumer Federation of America and the National Insurance Consumer Organization. Those are all groups that represent the people the factoring companies claim they're trying to serve and protect from insurers. Well, the factoring companies may not want to hear it, but these groups support this bill not because of some concern for insurers, but because the bill answers the problems faced by consumers who count on structured settlements to meet their needs.

Even J.G. Wentworth, which is the largest factoring company in the country, and the only one located in Pennsylvania, accepts the bill. They don't support it, but they don't oppose it. So much for the argument that the bill is an attempt to outlaw factoring transactions. The major player in the industry supports it, accepts it.

The only opponents of the bill come from a handful of other factoring companies. We had some extensive debate in the Senate, and a lot of meetings and correspondence with those out there, so I'm pretty familiar with their arguments. Since I don't get rebuttal time today, I'd like to touch on those arguments now.

Welcome, Chairman Micozzie.

Factoring companies, those that are complaining about this, they start with the pitch that they can accept 85 percent of what's in the bill. Sounds reasonable. Unfortunately, one man's 85 percent is another man's 15 percent. When you look at the objections that they have, they really want to gut many of the bill's protections or just make sure that nothing happens.

The first thing they like to say is, regulate insurers. What they want is, they want to have the bill's disclosures and independent counsel requisite apply when getting into structured settlements, just as you want when getting out. That's a red herring. It's like the old Three Stouges. If you can't defend your own actions, raise suspicions about others, the whole -- point the other way.

The short answer is, and that's all this deserves, is to remember the regulatory and judicial oversight that applies to insurers, oversight totally lacking with factoring companies. If factoring companies want to be subject to the same regulations; if they want to have to get licensed; if they want to have oversight of their financial and marketing practices; if they want to get in the area of rate setting; if they want the bad faith statute to apply to them too, maybe we can talk. But none of that exists now.

Then they like to attack insurers and they like to attack everybody else. It's really a cousin of regulating insurers. It probably sounds a little better. They claim that we want to restrict their transfers because it costs us money. How? With or without a transfer, we pay the same amount on the same schedule.

I have a couple kids myself so I'm actually sort of use to this. I assume everybody else here sort of been through the paternal bill.

We're paying the same amount of money with or without a factoring transaction. We have a potential tax liability, but the amount of the settlement, our amount of payment remains the same.

They also like to claim they are providing that valuable consumer service because some structured settlements aren't a good deal or can become outdated. Sometimes they say, gee, those settlements are really a conspiracy between insurers, agents and trial lawyers.

Let's use a little logic here. No factoring company is ever going to offer a consumer more money than he gets under a structured settlement. It's just the opposite. The amount is always less. There's always a discount there. Only the timing gets changed. If it's such a conspiracy, why do disability and consumer groups support bills like this one and the federal bills?

Then they say, well, let's -- Gee, we're okay with a lot of this, but let's limit that court approval. We don't want court approval unless the original settlement was also approved by a court, or unless the factoring transaction is over 25 grand. What that means really is, they want to exempt about 90 percent of all factoring transactions from court approval.

Now understand, the court-approval standard isn't our creation. That comes directly from the lottery law. It hadn't been a problem there for consumers or for the courts or for the factoring companies. Without it, the bill's protections for consumers are meaningless. Remember we talked about factoring companies not being regulated or audited or monitored by the state. If you don't have court approval, how else do you know if they are complying with the bill.

Then they like to say, gee, let's just exempt loans. That's really just creating a loophole. If you can set up the transaction as a loan with the annuity proceeds paying off the loan, then gee, none of this should apply.

Nice try, but it leaves insurers with the same potential tax liability, and it leaves consumers without the bill's protections.

They also like to say, gee, that final hardship standard, that's a little tough. Why don't you ease up on that and maybe go with the best interest standard. The argument we heard in the Senate was that, that hardship standard is too tough. It's going to keep, and I quote from the factoring companies, it keeps the richest guy in town from cashing out on a structured settlement, or the old guy who wants to take his grandkids to Disney World.

Let's get real. The richest or the oldest guy in town doesn't enter into a structured settlement in the first place. Factoring companies aren't marketing to the richest guy in town anyway. At least according to one factoring company, the average income of their clients is 20 grand. That includes what they get from the structured settlement.

I personally think that the hardship standard is a better one, and I'm not alone on that. So does the U.S. Treasury Department, the Plaintiff's Bar and the disability and consumer groups. The factoring companies say, those other groups would be okay with a lesser standard, but those other groups aren't saying that.

The point is, the standard isn't an insurance industry creation. It's the Treasury Department's proposal. That's the agency that's in charge of tax policy, so I think it makes sense that that be the standard for a safe harbor for all of us facing a potential tax liability. Remember, this bill automatically changes to whatever standard is ultimately enacted in Washington.

Then the factoring companies say, well, do away with this insurer veto power. That's a catchy phrase, but it's inaccurate. Senate Bill 818 says, an insurer has to get a consent to a transfer of the structured settlement, but only if that transfer violates the terms of the settlement and the insurer cannot unreasonably withhold it.

Factoring companies say, gee, we'll never get consent. It too harsh. Hogwash. First, as a general matter of contract law, one party to a contract can't unilaterally change it. That's what's called a violation of the contract. It isn't harsh to require both parties to a contract to agree to any changes. It's common sense.

Second, the bill talks about insurers not being able to unreasonably withhold its consent. That's a limit on insurers that's found in no other state with a consent requisite. The factoring companies say, we'll never give it. They obviously don't know our regulatory system or our Trial Bar. Of course, if a judge thinks in a particular case an insurer is acting reasonably in withholding consent, maybe it is.

Third, and I think it's important to remember, that consent requisite goes away once the tax issue is resolved, even if the transfer violates the terms of the settlement. We are out of the picture once the tax issue is resolved, no matter what language we put into a structured settlement agreement.

But still, consumer protections are going to apply, consumer protections in this bill. The protections that the consumer gets don't go away even once we're off the hook because of tax liability.

Then they like to say, there's no real tax problem here. We have Dave Lowman who is a lawyer down in Richmond, Virginia. He's got a tax lawyer expertise on this. He's going to talk a little later. I'd like to take a quick stab at a layman's analysis.

As I said at the outset, structured settlements are generally funded by an insurer purchasing an annuity, with the annuity insurer then making the payments to the claimant. The Internal Revenue Service, at Section 104 of the International Revenue Code, said that those periodic payments that the consumer gets, the claimant gets, they're tax exempt when you're getting them under workers' comp or personal injury settlements.

It also then says in Section 130 of the Internal Revenue Code, that the income the annuity insurer gets when the annuity is bought is also tax exempt. But there are two conditions to that. Those annuity payments can't be accelerated. In other words, you can't say, here, I'm suppose to be paying this every month for the next five years, but now I'm just going to give you a lump sum payment. And they can only go to claimants who qualify under Section 104; in other words, personal injury, workers' comp settlement, claimants.

Now, with factoring agreements, the payments have arguably been accelerated because the person who was getting them now gets a lump sum. The annuity insurer is arguably, but unintentionally, he's not making those payments to a Section 104 claim. He's making them now to the factoring company. So, the money --

That's our tax exposure. It's hard to claim that you fit within that Section 130 exemption when the payment has been accelerated as to the original claimant, and when the new party getting the money, mainly the factoring company, isn't a Section 104 claimant. Those are the two conditions set forth in Section 130 for the tax exemption.

The simplest way of explaining the tax exposure is simply to quote from the Treasury Department. They had a statement on March 18th on it. The administration believes that the factoring transaction underlies the purpose of the special favorable tax rules applicable to structured settlements.

The factoring companies quote from a former Treasury Department official that they retained saying we worry too much. But the current Treasury Department officials are calling this a tax problem, and they're the ones, not insurers, who are proposing a 50 percent tax and a financial hardship standard to limit factoring transactions. It's easy to minimize somebody else's tax exposure, but when it's your own, you have to listen to the Treasury Department.

Dave Lowman is going to give you some more details on this and he can talk about some recent developments at the IRS, but that's the core of it. These factoring transactions clearly go against the tax policy that led to structured settlements, and the IRS doesn't like it. My experience is that, we're a pretty easy target for angry regulators.

Then they like to say, well, we just talked about a federal tax policy. I guess this must really be a Washington problem. Why are we dealing with it here at the state level? You know, why don't we just wait for the feds to do something. That doesn't do anything for the consumer, and it doesn't do anything for the insurer in the interim, except needlessly put the insurer and the consumer at odds.

Of course, if you do something here, that's not going to be the first time Pennsylvania has set up protections in advance of Washington. Last year we did the Managed Care Reform Act in Pennsylvania and we did Mental Health Parity in Pennsylvania. Sometimes that's the only way to get Washington to act.

And then they end up and they say, adding all this together, the bill is just too onerous. Yes, Senate Bill 818 is too onerous for some factoring companies, those who want to continue in an environment with no parameters, no regulation, no oversight and no protections for those they deal with.

But it isn't onerous for consumers. It gives them the protections they need, and its cornerstones of disclosure and court approval have been shown to work in Pennsylvania. It also provides protections that insurers need from a potential tax liability.

I guess in the end, the best case

that I can make on this bill is to ask what you guys would do if you saw an insurer who, a couple of years after it entered into a structured settlement with a claimant, who probably had a lawyer; in 90 plus percent of the cases they do, called up the claimant and said, hey, do you want to cash out on that? How about a little quick cash here. Don't worry what we're doing. Nobody is ever going to know about it. Nobody is going to know what the terms are. We don't have to file anything with the state or anything like that. Let's just you and I sort of cash out on this.

If we tried to do that, I suspect there would be another meeting of this committee, probably a meeting with a few other committees out there, and the Attorney General would also be here taking a look at us. That actually makes our case better than I could make it through talking about factoring companies.

The bottom line here, this is a bill that fairly, thoroughly and efficiently protects all parties, including the factoring companies who want to legitimately serve consumers, not just engage in predatory practices. I urge you give it full consideration and strong support.

CHAIRPERSON CLARK: Thank you, Mr. Marshall, for your testimony. Are there any questions of Mr. Marshall from the Insurance Federation from anybody?

REPRESENTATIVE HENNESSEY: Thank you, Mr. Chairman. Sam, can you give us an example when a court might decide that something structured or a factoring transaction is in the best interest of the claimant; and yet, you foresee the insurance company refusing on the basis of financial hardship? Try to draw me an example of how the two would conflict.

MR. MARSHALL: When you look at the -- One of the things, financial hardship -- This is a federal term on that. They define it as an eminent or extraordinary change in a person's needs. You might have a person's physical condition changing, needs an operation; something else happens to the person. If the court says --

Everybody goes into court and says, here's a hardship that I'm suffering from. Maybe the insurer says, no, I don't agree. I don't think that's a hardship. That's for the court to decide. If the court decides it's a hardship, then it's going to get approval. That's the type of change that you see.

What you don't want -- And you also have -- When we talk about the financial hardship, you have to consider both the claimant and the dependent. Many times when you enter into a structure settlement, it's designed not just to take care of claimant but the claimant's dependents. Maybe you have college coming up down the road or have some further needs.

If you are to change that, it has got to be a real need; not just, hey, I want to get a new car, something that's sort of convenient or I'm just a little impatient. You need a real hardship, what would be an eminent change.

You can do that. For instance, it could be a birth of a child. That's an eminent change, that type of a thing.

REPRESENTATIVE HENNESSEY: I guess I'm just having difficulty trying to figure out when the court would decide that something is in the best interest of the claimant, and yet, still feel it was blocked because it didn't amount to a financial hardship.

MR. MARSHALL: You know what --

REPRESENTATIVE HENNESSEY: Ninety percent of the cases are probably -- the same evidence will meet both --

MR. MARSHALL: I think a financial hardship is a slightly higher standard. Frankly, speaking as a lawyer, if you're a decent lawyer I think you can make an argument either way and probably prevail. Our point, of course, is, the Treasury Department says this is the exact language that we want. This is the exact language that we're proposing.

It doesn't make sense to have a state standard be different from what the Treasury Department is proposing, certainly from our perspective because we have a tax liability concern. You don't even want that suggestion being raised that a state would apply a different standard, and, therefore, you're still subject to the federal tax liability.

I don't envision that you would have cases where the court says, we think it's a financial hardship, but the insurer objects to that. Of course, if that's the case, the insurer's objection would lose. The court controls. We might go in and say, no, we don't think it is a financial hardship. But if the court finds that it is, then so be it.

REPRESENTATIVE HENNESSEY: Thank you.

CHAIRPERSON CLARK: Representative Dermody.

REPRESENTATIVE DERMODY: Thank you, Mr. Chairman. I'm not real familiar with structured settlements, or been involved in many, but I get the sense that they used to be mostly used when somebody had suffered a catastrophic injury. I'm also getting the sense now they're being used to settle all types of cases. I'm just wondering if you could talk a little bit about the growth and the use of structured settlements.

MR. MARSHALL: I think a lot of people think of it in terms of catastrophic injury because of medical malpractice and that's where you frequently see it. It doesn't have to be catastrophic injury, you know, which would suggest that it's only very large numbers. I don't think even --

That's probably where it's most frequently heard of because, simply, that's where the biggest numbers are. No, it's not limited to catastrophic injury.

To some extent, it's understandable on the claimant's side as well as on the insurer's side. When the federal government says, here, we're going to have a tax policy that encourages you to use these, people use them more and more.

Because of the tax-exempt status, it actually serves to get more dollars to the claimant, I guess out of the insurer's pocket, but because of the tax-exempt status, it's ultimately out of, I guess, the federal budget side.

REPRESENTATIVE DERMODY: In your experience, the growth has been greatly increasing in the last few years?

MR. MARSHALL: It's actually -- I mean, if you talk to trial lawyers, in part because of some of the concern about what's going on with factoring transactions and the problems that surround those. I'm not sure that this is necessarily a growing area.

REPRESENTATIVE DERMODY: Structured settlements?

MR. MARSHALL: Yes. When you have -- One of the things I mentioned about tax liability being a problem for insurers, when you have a liability concern and you say we're not exactly sure what's going to happen when these things get factored out and thought out, that's a real disincentive to use it. I think that's actually one of the -- It's one of the reasons that we need protection. We need protection to be able to continue to offer them so claimants can continue to get them.

It doesn't make sense for anybody -- That's why -- Sometimes you hear factoring companies say, structured settlements are a bad thing. That structured settlement factoring companies have no product to offer. They need structured settlements to continue just as much consumers or claimants do.

REPRESENTATIVE DERMODY: I understand. I was wondering, the numbers, are they going up? That's what we're hearing. If we have the need to regulate, there must be growth in the number of structured settlements.

MR. MARSHALL: The growth in the numbers is actually the growth of the number of factoring transactions buying out structured settlements. That's the real problem.

REPRESENTATIVE DERMODY: Thank you.

CHAIRPERSON CLARK: Representative Dally.

REPRESENTATIVE DALLY: Thank you, Mr. Chairman. Sam, have you seen instances where the provisions that are in this proposed bill are incorporated in settlement documents? I would think some of this would be covered with settlement agreement between the plaintiff and the defendant, or doesn't it work that way?

MR. MARSHALL: What usually happens, you'll have in a structured settlement an anti-assignment clause. Then you get caught into two arguments. The first is, is it an assignment? What frequently happens when a factoring company comes in and buys out, the insurance company doesn't even know about it. It's just a change-of-address form. The name and what happens is, the factoring company says, here, sign a power of attorney over to me, so the insurance company doesn't necessarily even know it's happening.

We process changes-of-address forms. If you look into every single change-of-address form and figure out whether that was now going to a factoring company, who really own that P.O. box, you'd go crazy. So you don't necessarily know it because they say no, it's not an assignment. The name on the check remains the same. The fact that John Doe decides to sign it over to us and it's signed over to confession of judgment clause, and all that, you're none the wiser for it.

When it is an assignment, you get into a fairly labyrinthian UCC, Uniform Commercial Code, analysis. I don't want to try to go through that here on a Monday morning because my brain's not working quite that fast, and I'll be happy to supply it for the committee.

There is a case in New Jersey that said, this type of anti-assignment clause found in the structured settlement agreement is not valid. The overwhelming majority of the jurisdictions, and that case in New Jersey is on remand and there's some fairly colorful factual patterns that have emerged there. But by and large, those anti-assignment clauses have been ruled out. Of course, the factoring companies say, hey, no assignment. The name on the check remains the same.

REPRESENTATIVE DALLY: So do you believe that absent legislation, you really couldn't put stricter language in the agreements?

MR. MARSHALL: No, because you just don't know. What you're really -- Do we have a tax concern? Yes. I've spoken at length, and I hope with some clarity, and Dave Lowman is going to speak with, I hope not quite as much length, but with greater clarity later on about that. But you have a real consumer problem on this.

The transactions aren't necessarily bad. There are instances Representative Hennessey suggested where they're good. They meet a legitimate consumer need. Nobody is trying to ban factoring companies or ban transactions. That's why actually we work with J.G. Wentworth, which is one out there from Pennsylvania, on it.

What you do need to make sure,

though, is that people know what they're getting into. It's the same type of regulation we're under. When you look at the Managed Care Reform Act, a lot of that was consumer disclosure. When you look at the life insurance and marketing practices you guys enacted five years ago, it was all disclosure. Let the consumer know what's going on. You need to have a law to do it so that there is some way that the Commonwealth can come in and say we want to make sure that you're doing it.

One of the things that the Attorney General -- One of the amendments that the Attorney General put into Senate Bill 818 was to clarify that his office had jurisdiction over any violations of this bill so that he could go in and examine and audit and investigate. I think that's important.

REPRESENTATIVE DALLY: Thank you.

CHAIRPERSON CLARK: Representative Josephs.

REPRESENTATIVE JOSEPHS: Mr. Marshall, are you saying that if we don't adopt one of these versions, that the insurance industry would stop as much as you can offering the structured settlements altogether?

MR. MARSHALL: No. First of all, I'm hoping that that not be the case. Secondly, we were pushing for clarification, and the Treasury Department is pushing for clarification of our tax concern at the federal level. If you don't adopt -- It's obviously a deterrent for our industry. If you have potential tax exposure, you're reluctant to do it.

The one thing that I find is that, even among the Plaintiff's Bar, you talk to plaintiff's lawyers, they are getting more and more reluctant to go into it because they worry about their client down the road without them being involved getting hit in some buyout that may or may not be a good deal.

Now, one of the things you have to look at in this bill, it's a protection from us and it addresses our potential tax liability. That's important to my clients. But, it is also a protection to the claimant so the claimant knows what's going on. It's the same thing you did for the annuity people -- or for the lottery people.

REPRESENTATIVE JOSEPHS: Thank you.

Thank you, Mr. Chairman.

CHAIRPERSON CLARK: Representative Micozzie.

REPRESENTATIVE MICOZZIE: Thank you. Welcome Sam. How are you?

MR. MARSHALL: Mr. Chairman, good to see you.

REPRESENTATIVE MICOZZIE: Structured settlements, are all settlements structured now? I mean, are there any annuities that the consumer and the investors, of course, mandate a structured settlement or are they all structured settlements?

MR. MARSHALL: No. In a lot of claims it's not a structured settlement as an extended payout. Obviously, a lot of litigation ends in just, you write a check. Here. Over and done. It's not extended over a period of time.

Of course, within the annuity business, structured settlements -- annuities being used to fund structured settlements are one segment. I can't give you a percentage on it, but it's one segment of the annuity business. There are companies that --

G-Capital, obviously a major Pennsylvania presence. G-Capital does an awful lot in terms of structured settlements; you know, issuing annuities to fund structured settlements.

For a company like that, it has a huge, potential tax exposure. The arguments that I raise today, if the Treasury Department came out and said, G-Capital, we're going after you, G.E. would fight tooth and nail against the feds whacking some tax liability.

When you settle a claim, how many go into structured settlements versus how many just gets one check and done? Don't have an answer for you on that.

REPRESENTATIVE MICOZZIE: Is the insurance companies the only ones who have a tax liability if you went into a structured settlement?

MR. MARSHALL: Yes.

REPRESENTATIVE MICOZZIE: How about the consumer and the investors, and whatever, do they have a tax liability?

MR. MARSHALL: Well, the factoring company doesn't have a tax liability. It has no tax exposure. The factoring companies themselves in a number of their purchase agreements has said to the consumer, hey, now look, you may have a tax concern here.

Frankly, I think the IRS issued a recent ruling saying that consumers don't -- saying they didn't -- at least one particular case the consumer didn't have a tax liability, specifically said we're not talking about the annuity issue.

I think there is a theoretical tax liability to the consumer. I'm not sure I can envision the IRS going after the consumer on that. I think that's a little bit what happened in this letter ruling that Dave Lowman is going to talk about. I don't think the IRS has that same reluctance to go after insurance companies, so it's mainly our tax exposure.

REPRESENTATIVE MICOZZIE: When you start talking about present value and future value of a settlement, does the insurance companies stand to make more money on extended structure settlements than they --

MR. MARSHALL: No. You don't make more money. That's -- You know, the terms are the terms. You don't make more money.

Generally, when we issue an annuity, as you know, because of Life Marketing Act which applies to annuities as well, came out of your committee, all of that present value has to be disclosed. That's all pretty well known. The annuities have to be filed with the state and approved by the state.

What is missing in a structured settlement are those same types of disclosures. Generally in terms of a structured settlement you're going to pay out more, but you're going to have more time to pay it out.

REPRESENTATIVE MICOZZIE: So the insurance industry's concern is the tax liability and the consumer's interest. Is that what you're talking about?

MR. MARSHALL: Correct.

REPRESENTATIVE MICOZZIE: Nothing else?

MR. MARSHALL: Correct.

REPRESENTATIVE MICOZZIE: It just seems to me there has to be something more involved in this that I'm missing.

MR. MARSHALL: And I know a lot of

people say, gee, there must be some sort of conspiracy here.

REPRESENTATIVE MICOZZIE: I'm not blaming the insurance industry. I'd never do that. You know that, Sam.

MR. MARSHALL: That's what it is.

REPRESENTATIVE MICOZZIE: Thank you, Mr. Chairman.

CHAIRPERSON CLARK: Representative Cohen.

REPRESENTATIVE COHEN: Thank you, Mr. Chairman. Good morning, Sam, again. Just getting back to what Representative Micozzie asked about consumer protection.

When a structured settlement is offered, what kind of protection and what kind of information, really, is provided to the claimant in terms of fees, rebates, commissions paid to the parties that are setting up this settlement, value of the cost of the periodic payment stream, anticipated rate of return? Is that information supplied upfront and how is it delivered?

MR. MARSHALL: When you're providing it upfront, what you're saying when you enter into the structured settlement, you're saying here -- I think it's about 95 or 96 percent of the cases the claimant has his own lawyer. Don't involve the red herring. There's always got to be a lawyer involved. For the most part there is. Frankly, except for fairly small cases where -- I'm a lawyer so I believe in having lawyers, but you probably don't need a lawyer.

You wouldn't necessarily say, here are the fees and all that kind of stuff. What you are saying to the person, take your claim. I can either pay you 25,000 right now or I can pay 40,000 over the next three years. Here's what the terms of the payment are. You know, how much it cost me to offer you that 40,000, or how much it cost me to offer you that 25,000 is really immaterial.

The reason you need that when the person is thinking about buying out is so that the person can evaluate whether what he's getting currently through the structured settlement, how does that stack up against a cashout.

If I'm getting 40,000, it's probably

not an easy number to work with, but if I'm getting $40,000 over three years and somebody comes along and says--That means I'm getting, twelve, $13,000 a year, maybe a little over a thousand a month--somebody comes and says, hey, you know, Sammy, here's ten grand right now. Sounds good. That's tenfold what I'm getting each month.

But somebody breaks that down and says, Sam, here's the present value of the $40,000 that you're going to get, and by the way, that 10,000 that we're going to give you, well, actually we're going to take out a few fees, and a few transactional costs, this and that, so when you finally get that check, it's only going to be for 8,000. That's what we are saying has to be disclosed.

When an insurance company settles going into it, and, of course, there's generally lawyers involved on both sides. The second people are engaged in any sort of misleading or somehow unfair practices, the Insurance Department is going to come in because we are state regulated.

I guess you can say, here, we want

to disclose the fees, but those aren't fees that even go to the claimant. They don't come out of his pocket. They don't come out of his settlement.

This is a matter of how we fund the settlement, but we agree on the settlement first. Then you figure out how to fund it. You don't even have to use an annuity to fund the structured settlement.

REPRESENTATIVE COHEN: Thank you.

CHAIRPERSON CLARK: Mr. Marshall, let's say that I have a structured settlement. I'm receiving payments over some period of time and maybe some lump sum payments. I decide I want to buy into my father's business. I go to the insurance company who has this annuity or a schedule of payment and ask them if I can have a lump sum or buy out the contract, whatever, so I can put this money and buy into my dad's business. What will they tell you?

MR. MARSHALL: That they're not allowed to do it. Frankly, that was why I closed my testimony saying, here, imagine if we did it. If you think about it intellectually, we might not have any problem with doing that.

We'd probably get a better deal.

You have some and now you want to buy into your dad's business, we could probably take the amount that we have to pay you and greatly reduce that. And it probably would be financially a better deal for us.

It's not like the factoring company ever offers somebody more money than he was going to get. That was my point there. If you are going to get a hundred thousand dollars over ten years and now two years into it you want to buy into your father's business, you're not going to -- you're not going to the factoring company -- The factoring company isn't giving you the money upfront and saying, gee, I'm going to take a hit on this, but I believe in you. It doesn't work that way.

If an insurance company wanted to do that, the insurance company intellectually, economically wouldn't have any problem with it. But we're not allowed to do that under the tax rules. We can't do that.

CHAIRPERSON CLARK: Because it's not a hardship?

MR. MARSHALL: Yes. Well, we can't

do it because, under Section 130, which gives us -- that's what supplies insurance companies with a tax-exempt status. We can't do that under Section 130 because we would no longer -- because we would have just accelerated the payment. You would have to change the Internal Revenue Code to allow us to do it.

What the Treasury Department is proposing is, say a third-party can come along -- the factoring company can come along and it can buy you out, but it can buy you out only if there's a financial hardship showing. Whether you can make that case with, say, buying out your father's business, here's an extraordinary, eminent change in circumstances in the language that's in Senate Bill 818 on that, that's between you and your lawyer. You can go to a court and you do it.

CHAIRPERSON CLARK: So the insurance company's objection is going to be, there's a tax liability to them.

MR. MARSHALL: Correct.

CHAIRPERSON CLARK: Can't they factor that in and say, well, we have tax liability but we can still give you "X" number of dollars in a lump sum on a contract?

MR. MARSHALL: Except we're not in the business of violating the tax code.

CHAIRPERSON CLARK: Well, you're not. You're just not being able to take advantage of that and say, well, take it out of my IRS ahead of time. I'm violating --

MR. MARSHALL: If you did, it just wouldn't be worth it.

CHAIRPERSON CLARK: The number you would give me back would be such a bad deal, that I'd look at you and say, forget it. We'll go to the bank and borrow the money?

MR. MARSHALL: Yes.

CHAIRPERSON CLARK: Brian Preski.

MR. PRESKI: Sam, I just have one question. As we did the research for this, the one term that kept coming up was a structured settlement broker. Is that the same as a factoring company?

MR. MARSHALL: No.

MR. PRESKI: Just what are they?

MR. MARSHALL: I'm not sure where you -- where, when you did the research, you kept coming up with that term.

MR. PRESKI: It seemed that they were coming up more in the front end of it, and kind of almost that they were an arm or a group that was used, maybe, by the insurance companies or something else to put these things together.

MR. MARSHALL: To the extent that a structured settlement is funded through an annuity, it would be a broker that would place that annuity.

MR. PRESKI: I guess as I tried to formulate this my question becomes, when the Insurance Federation reaches a settlement on a case, do you have the annuity set up? Do you go to an outside firm then? That's what I'm trying to figure out.

The structured settlement broker, is that somebody who comes in and says, hey, insurance company, you want to pay out "X" amount of dollars? I can set it up so that it becomes this amount over time. Maybe this is better for Mr. Dyer to talk about.

MR. MARSHALL: Let me take a stab. If State Farm -- You get in a car accident and you have a broken leg, and it's a badly broken leg and you're going to miss work for the next two years. So, State Farm in paying your claim says, here, we're going to pay you over a two-year period. We'll enter into a structured settlement for that.

State Farm and you very well may say, gee, that's great. Let's take advantage of the fact that the federal tax policy says bingo, use structured settlements. Let's do this through a Section 130 annuity because I'm a personal injury, I'm a Section 104, under the Internal Revenue Code Section 104 personal injury claimant. Let's do this through an annuity.

State Farm says, okay. State Farm to pay you that money over a two-year period goes and buys an annuity to do that. It would use a broker or an agent to purchase the annuity. It might use a broker or an agent to purchase the annuity.

MR. PRESKI: Okay. Thank you. It appears he'll add more to that when he comes up.

CHAIRPERSON CLARK: Any additional questions? Representative Gannon.

REPRESENTATIVE GANNON: Thank you, Mr. Chairman. Sam, I heard Representative

Cohen's question about the disclosure, the consumer protection disclosure at the time that the transaction takes place initially, when the claim is settled and the offer is made. I didn't quite understand the answer.

What specifically is the claimant told either directly or through the claimant's lawyer, if there's an attorney involved, about what the financial dealings are behind the structured settlement?

For example, if a case is being settled for a million dollars and that's going to be set out over a period of years, what information is given to that claimant other than the fact that you'll get a million dollars payable in certain periodic payments that may vary in amounts? What other information --

MR. MARSHALL: Obviously, that's the key information. The person would also be told, here, here are -- And then when you enter into a structured settlement, that's why you have, for instance, in a settlement agreement an anti-assignment clause because you'd also be told, now look, these are being given special tax agreement which we can't assign. We can't accelerate these and our payments have to go to you.

REPRESENTATIVE GANNON: I understand that. What I'm getting into is, the claimant says, well, this million dollars is going -- We're going to have to write a check to an annuity company for "X" number of dollars to purchase this. We're going to pay commission to "X", to whoever, for this transaction. We're going to pay an interest rate of this. You know, all this specific information.

So now, the claimant can either directly or through their lawyer, or whatever, through their financial -- it's probably better for me to take that money and invest it myself and get a return on it, or let the insurance company go out on the marketplace and make the best deal they can to purchase this million dollars.

MR. MARSHALL: Obviously, everybody's lawyer is going to represent them differently. I suspect what the lawyer says is, I can get you a million dollars paid over ten years or I can get you 500,000, or whatever the numbers he's negotiated on, today. They go in and they figure out which they want.

REPRESENTATIVE GANNON: When I look at this legislation, and I perused it, I haven't read it in detail, there's a lot of requirements, much more onerous requirement on the factoring company to disclose all the dealings behind the transaction than with the insurance company when it's at the front end of the transaction.

I'm wondering, why wouldn't a company say, yes, we'll tell you what the interest is, what we're paying and how much it's going to cost us.

MR. MARSHALL: I don't know that the disclosure -- I don't think you get any disagreement from the factoring companies on disclosures. They are fairly common-sense disclosures. It's saying, here's what the discount is, what you're getting now versus what we're offering. That's essentially what the terms are.

Obviously, if the person has to pay any fees and that's coming out, then they ought to be aware of that. You don't have those same fees and discounts applicable when you enter into a structured settlement because there it's just comparing what you get if you took it right now versus what you get if you pay it over time.

As I mentioned before, our answer to that, somebody wants to come along and say, here, we want to impose a new layer of regulation on the Trial Bar and on insurance companies so when they enter into structured settlements, that the claimant has to get the following disclosures, we can talk about that. I'm happy to talk about that.

My short answer on all of this is, remember the level of regulation to which we are subject. Our marketing practices, our claim settlement practices are routinely audited by the Insurance Department. They are subject to the Unfair Insurance Practices Act.

As you know, probably a little better than some of the others in Harrisburg, we have a bad faith statute. That applies to our dealings every day and in every way. None of that is applicable to a factoring company. There is absolutely no oversight over their dealings with consumers; nothing along the lines of what we face.

REPRESENTATIVE GANNON: I understand what you're saying. But, once you have completed the transaction, you have -- Somewhere in this agreement you have taken a general release from the claimant. You've now released your insured from any further liability forever with respect to the cost of the claim.

The next thing I assume you have done, you have taken the casualty company -- I'm going to use that for purposes of discussion. You have taken the casualty company and you release them from any further obligation to the claimant somewhere in these documents. Then what you've done is, you have transferred that obligation to some outside company. It could be an insurer. It could be some bank, I guess, that sells annuities?

MR. MARSHALL: Well, no, not that would sell. It's going to be an annuity issue. So it's going to be an insurer.

REPRESENTATIVE GANNON: Is that annuity insurer, whether it's a bank, a life insurance company or some other financial institution, are they subjected to the same regulatory overview that, say, the insurance company is?

MR. MARSHALL: Sure, because, to issue an annuity in the Commonwealth of Pennsylvania you have to be a licensed insurer.

REPRESENTATIVE GANNON: Okay.

MR. MARSHALL: You have to be licensed by the Commonwealth of Pennsylvania, and therefore, you are subject to the Unfair Insurance Practice Act, with auditing and all that that goes on with the Insurance Department.

This is not an insurer making some agreement with some Turk Caymen Island, you know, unlicensed entity or with a bank. These are annuity issuers. To issue annuities in Pennsylvania, you have to be licensed as a licensed insurer.

REPRESENTATIVE GANNON: But they don't have to be located in Pennsylvania. In other words, I can be a company in California and --

MR. MARSHALL: Not any more than State Farm is located in Pennsylvania. As I suspect you know, for clarification for other members of the committee, if you are licensed in Pennsylvania under the insurance clause, that also serves to subject you -- automatic service in process and things like that. You are right away subject to the Commonwealth's jurisdiction even though your principal office may be in another state. That holds true for property casualty companies as well.

REPRESENTATIVE GANNON: This is going to be, hopefully, not a complicated question. I'm not trying to put you on the spot. You answer fine (drops voice; inaudible words).

When you settle a claim and you write a check, let's suppose it's a lump sum settlement, let's say it's a million dollars. You've agreed the claim has a value of a million dollars and you write a check ultimately to the claimant for a million dollars.

As far as the claimant is concerned, there's no tax consequence. That is a tax-free transaction as I understand it in the code, so there's no tax liability that the claimant has or that the insurer has other than the regular tax liability for reserves or whatever. Am I correct?

MR. MARSHALL: Yes. For the tax

questions, as much as I hate admitting, there are people a lot smarter than me, there are, and Dave Lowman will be following me. Maybe you want to save that tax question for him.

REPRESENTATIVE GANNON: What I wanted to ask you is why, if that million dollars is paid over a period of time rather than a lump sum, why does that now become an interest in tax consequences?

MR. MARSHALL: I think Dave is the best person to speak to that.

REPRESENTATIVE GANNON: Thank you.

CHAIRPERSON CLARK: Representative Hennessey.

REPRESENTATIVE HENNESSEY: Thank you, Mr. Chairman. I just like to ask one follow-up question so I can get something straight in my head.

You make an offer of a half a million dollars to somebody in a lump-sum settlement or a structured settlement paid out over ten years for $750,000 a year, whatever. Is there an equivalent between the 500,000 dollar lump sum and the structured settlement over ten years? Does that have to be equal? Do we simply say, present value of $750,000 paid out over ten years equals $500,000?

MR. MARSHALL: No, that doesn't have to be equal. I'm not sure --

REPRESENTATIVE HENNESSEY: It would seem to me that once somebody says I'll opt for the 750,000 over ten years, nobody is around to say, well, that's not really the same thing as the $500,000.00. Because there was a settlement, we'll just walk away from that.

I guess the bottom line to my question is, who makes the money on that transaction? From your testimony it seems like something which was unheard of 20 years ago is now the norm in 90 percent of the cases, that folks do that. Sam, your testimony indicated that 90 percent of these factoring transactions would be not affected, I guess, if we went to different standards.

MR. MARSHALL: I'm sorry. Let me clarify that. What I was talking about in the 90 percent was the factoring companies. One of the things that's in Senate Bill 818 and House Bill 825 is that, there has to be court approval. That's exactly what you have for lottery winners.

What the factoring companies say, gee, let's limit how much court approval is needed. Let's have it only if the structured settlement itself was originally approved by the court.

Well, by virtue of the definition it's a settlement, it's not a court-approved settlement. It's settled before you go to court or it's settled in lieu of a court resolution.

Or they say, let's limit them to -- let's knock out any of them that are under 25 grand. The net effect of that is to say, here, you don't have to go through the court approval.

That's a whole different area than I think what you're asking about, which goes into the question of when you enter into a structured settlement, is it always just take whatever the present value of the money is and extrapolate it out. It may not be.

Sometimes you go into a structured settlement, your lawyer may set you up because you have children. You say here, you know what? I want to make sure under --

The papers are full of stories. You

usually see it in the sense of a lottery winner who wins $10 million today and three years from now he's bankrupt. Those things happen.

What you look at in a structured settlement, your lawyer may look at, you have some young children. I'm going to make sure that when they become of age to go to college, there's still going to be money there. I want to put you into a structured settlement, frankly, because it's fiscally -- it's requiring some level of fiscal prudence on the claimant.

I mean, if you pay me $200,000 a year, I'll spend $200,000 a year. You may pay me a hundred thousand dollars a year, I'll spend a hundred thousand dollars a year. People tend to spend that which they have. A lot of us don't save for a rainy day. A structured settlement is essentially an agreed-upon, almost a mandatory savings for that rainy day down the road.

REPRESENTATIVE HENNESSEY: Are you saying that the increase, almost a boom in structured settlements is being driven not by the insurance companies as the payers of these amounts, but rather as the Trial Bar trying to do service to its clientele?

MR. MARSHALL: It makes sense -- It makes sense from all parties. I wouldn't --

REPRESENTATIVE HENNESSEY: Who is pushing it? Is the insurance industry saying, let's have more and more structured settlements, or is the Trial Bar saying we love structured settlements?

MR. MARSHALL: I think it's both. I don't want to -- I'm not sure I refer to it as a boom in structured settlements. In fact, one of the questions that Representative Josephs has asked is, should we pull back from it. Different lawyers are going to approach it in different ways. Different claimants are going to generate structured -- it makes sense to have a structured settlement or it's not.

What we're saying is, it is a good part of the landscape. I think it's a good part of the landscape. It's a good option to use, but you have to make sure that if you are using it, make sure it's used fairly on all sides. What this bill does is make sure, once into it, the people that are into it are dealt with fairly if and when they are solicited to get out.

REPRESENTATIVE HENNESSEY: I guess the question I would have then, to go back to my earlier question, before you enter into this agreement, is there anything that regulates the insurance companies as the ultimate payers of the amounts that are involved to be fair and not to make money on that transaction which converts it from a lump sum, half a million dollars to 750,000 over ten years?

Is there any kind -- I think you said there's no equivalence there; there's no reduction to present value of the seven fifty out of five hundred --

MR. MARSHALL: One of the things, when you refer to the theory we're making money on the transaction, there's a little bit of -- That's a misnomer. It's not as if we sit there and say -- It's sort of an either/or. It's not a transaction. It's a settlement that you're entering into. You're a putting a dollar value on a claim against --

REPRESENTATIVE HENNESSEY: I'm trying to find out if that dollar value is the same if you take a lump sum or --

MR. MARSHALL: And you want to say, here, let's compare, you know, present value versus the structured settlement value. You know what, I don't know that I have any problem with doing that. The one thing that I do think is -- The one thing that is disappointing to me was, what happens in all of this is, everybody says, don't look at me. Look at the other guy.

The fact is, if we were bad guys on that, you'd already know it because we would have already been whacked by the trial lawyers, saying, you guys are using structured settlements and ripping people off. We would have more bad faith actions against us than Representative Gannon could up with in a day. You know, we would be audited by the Insurance Department.

When we have had marketing problems, when we have had claim settlement problems in our industry, because of the extensive amount of regulation and legislation and judicial oversight that applies to our industry, it gets uncovered very quickly and it gets dealt with very severely.

What we are dealing with here is an

industry that is subjected to absolutely no regulatory legislative or judicial oversight. As I said in my testimony, what we're looking at in this bill is to regulate the transaction itself. Frankly, I doubt that the Commonwealth of Pennsylvania is going to have a department of factoring companies. Just don't think that's going to happen.

If somebody wanted to do that, if somebody wanted to say, rather than regulate the individual transactions, the factoring companies, let's regulate the factoring companies themselves.

As I said, I'd be happy to talk about it. I just don't see Pennsylvania setting up a department of factoring companies. Therefore, the only thing that you can do is regulate the transaction itself to ensure that same level of oversight over what they're doing as over what we're doing.

To go about it two different ways it makes sense because the industry is two different sizes. The bottom line is the same. You're protecting the consumer.

REPRESENTATIVE HENNESSEY: Thank

you. Thank you, Mr. Chairman.

CHAIRPERSON CLARK: Let me ask you one question. Your concern, if we pass a bill and you maintain your tax benefit, it's still bothers you where the ultimate payment goes because you're interested in consumer protection.

MR. MARSHALL: What we have said in the bill -- Once our tax concern is taken care of, we're out of the picture. We don't have to give consent. We don't get to give consent in the instance of court approval.

CHAIRPERSON CLARK: Then you're not interested in the bill then?

MR. MARSHALL: No, that's not fair to say.

CHAIRPERSON CLARK: Okay. Then why are you interested in the bill after that?

MR. MARSHALL: Frankly, we are interested in -- I know you and I haven't dealt that often together, but I've dealt with a number of people on this committee in terms of who this organization is, what we do.

We do believe that consumers be dealt with fairly in any transaction related to an insurance -- that has in any way, shape or form a connection with our industry. I do believe that people ought to be treated fairly on things like that.

We went and we have worked with consumer groups, we have worked with disability groups, we have worked with the Plaintiff's Bar to make sure that that happens. The fact that our primary interest --

CHAIRPERSON CLARK: There are horror stories that develop from these that are giving the insurance industry a black eye.

MR. MARSHALL: No. You know what, there aren't any horror stories in any of this to give the insurance industry a black eye.

CHAIRPERSON CLARK: Once a factoring company comes in and then there's a horror story about somebody who got a lump sum, whatever, and they blew the money, you think it's going to affect the insurance industry?

MR. MARSHALL: No. I think it affects the consumer. And I think it affects -- And do we have a concern for consumers in this Commonwealth? Yes, we do. Is our main concern the tax concern? Yes, it is.

We have worked with consumer groups on this. We have worked with the Plaintiff's Bar on this. We have worked with the Attorney General's office on this. We have worked with the disability community on this. We have done that because I think everybody realizes that if the consumer isn't well served, all of us who are trying to serve it are ultimately hurt.

CHAIRPERSON CLARK: Representative Micozzie.

REPRESENTATIVE MICOZZIE: I have a short question. Did the Senate do anything on their bill? Did they have hearings? Have they had --

MR. MARSHALL: Nothing as lengthy as this, as we have crossed the hour threshold. the Senate did have --

REPRESENTATIVE MICOZZIE: We're more thorough.

MR. MARSHALL: The Senate Judiciary Committee in leading to the passage of Senate Bill 818 had two, what I'll call quasi-hearings. They had meetings on it. In both meetings we were called up, as were the factoring companies. One meeting was in May. Both groups were asked questions. Concerns from some of the senators were raised.

There was between May and June some extensive dialogue among all parties. The Senate Judiciary Committee then voted on the bill in June. An amendment endorsed by the factoring companies was defeated, I believe by a vote of 10 to 3. The bill was then unanimously passed out of the Judiciary Committee and was then considered, I want to say a week later before the Senate recessed, and it was passed unanimously in the Senate.

REPRESENTATIVE MICOZZIE: One amendment by the --

MR. MARSHALL: The factoring companies had proposed an amendment that was proposed at the Senate Judiciary Committee by, I believe Senator Brightbill. That was the one that went down 10 to 3.

There were two other amendments. I think both were proposed by the committee chairman, Senator Greenleaf. One addressed a concern from the banking association to clarify the nomenclature as to banks. The second reflected items sought by the Attorney General's

Office, you know; essentially strengthen the bill, as I mentioned, clarifying the Attorney General had jurisdiction over the factoring companies that might violate their --

REPRESENTATIVE MICOZZIE: What was the amendment of the factoring companies?

MR. MARSHALL: The amendment of factoring companies I believe would have taken out the financial hardship standard and I think reduce the insurer consent requisite.

REPRESENTATIVE MICOZZIE: I guess we have to ask the factoring companies, but there are only two things that concern the factoring companies?

MR. MARSHALL: When I went through my testimony -- I'll let them speak for themselves. What I raised in my testimony were all the myriad of arguments that we have heard this year from the factoring companies, ranging from regulating insurers, which I see a number of people here asked about, to, gee, you don't really have a tax problem.

REPRESENTATIVE MICOZZIE: Are you satisfied with the Senate Bill?

MR. MARSHALL: Yes, sir.

REPRESENTATIVE MICOZZIE: Thank you.

CHAIRPERSON CLARK: Representative Gannon.

REPRESENTATIVE GANNON: Thank you, Mr. Chairman. You know the percentage of cases where there is a final judgment, the case has gone to court and the parties -- the issue has been litigated and the jury or a judge has made an award in favor of the claimant. What percentage of those are then reduced to an annuity?

MR. MARSHALL: I don't know that. Randy Dyer with the National Structured Settlement Trade Association may have more answers on that, but I don't know.

REPRESENTATIVE GANNON: You had mentioned earlier there was some consideration in this where there was children involved and they wanted to make sure that the structured settlement was done to make sure the kids were taken care of. Would that type of settlement require a court order, court approval in a --

MR. MARSHALL: I'm sorry. That's if the minor was the claimant; you know, was the plaintiff in it. What I referred to is that, many times a structured settlement is set up.

I'm a father of two children, two young children. If I entered into -- If I was in an accident, for myself I may want the money right upfront. But my lawyer representing me might say, you know what, Sam, actually, your kids are going to be getting older and they're going to need some money. Why don't we go into structured settlement to make sure that ten years from now you haven't blown the money; that there's still money coming in to help the kids with college education, whatever your children may need help with.

In that instance they're not the plaintiffs, but nonetheless, they have an interest in my structured settlement.

REPRESENTATIVE GANNON: I don't think I heard you say this, but correct me if I'm wrong. That is, sometimes the claimant will be offered an alternative. In other words, we'll settle your case today and we'll write a check for a hundred thousand dollars, or we can do a structured settlement and pay you $250,000 over a period of years. Is that done or not?

MR. MARSHALL: Yes.

REPRESENTATIVE GANNON: The reason I say that, that seems to me, now the company is trying to sell an annuity as opposed to settle the claim.

MR. MARSHALL: No. I know you deal with claims from time to time from the plaintiff's end. It's not uncommon in a claim situation for your own lawyer to say, look, I can get you a hundred thousand dollars now or I can get you $200,000 paid over three years. Let's talk about which is the better deal, which meets your needs more.

Many times your own lawyer will say, I can obviously get you the money upfront, but given your level of investment savvy and things of that nature, I want you to get the money paid over time.

When we went into this, we talked to some of the high-profile Plaintiff's Bar people and they said, yeah, we want -- in many instances we want our clients going into a structured settlement because they couldn't handle a huge amount of money upfront; you know, the financial sophistication is lacking, whatever the case may be. We want to have the money coming in over time.

That tends to be something that's more negotiated by the plaintiff's lawyer. Just as I think Representative Hennessey asked, who is pushing these. It's a bit of both. It's been on both sides. It varies depending on the claim.

REPRESENTATIVE GANNON: Just an observation. I was just looking through the bill here. It's got this petition that has to be filed by, I guess, the company, the factoring company.

MR. MARSHALL: By the payee.

REPRESENTATIVE GANNON: By the factoring company. These requirements about interest rates, commissions, brokers' commissions, application of processing fees, closing costs, filing or administrative charges, legal fees, notary fees, commission fees, costs, expenses, legal fees.

What's wrong with requiring an insurer at the front end -- requiring the insurer to disclose that information to the claimant and his attorney when they're attempting to resolve the case with a structured settlement?

MR. MARSHALL: I don't think there's anything inherently wrong with it. One of the things, he could miss out on that. The claimant isn't getting an annuity. His structured settlement is being funded through an annuity. There's a difference there.

If you enter into an annuity, actually, right now you do get all those disclosures. If you are the annuity, you get those disclosures. That's not what happens in a structured settlement. Federal tax policy encourages the use of annuities to fund them. It's not like you become an annuity. You're not going off and buying an annuity. What you are getting in a structured settlement, you are getting extended periodic payments.

In fairness to the factoring companies, even those with whom we have a dispute, I think everybody is in agreement, yeah, these are reasonable disclosures to get. Are they detailed? Sure, so there's no ambiguity in there. Is it onerous? No, it isn't.

These are fairly boiler type --

these are the same type of disclosures that we insurers get when we do issue an annuity. These are the same types of things we get -- For instance, you remember the life insurance illustration. That whole law that applied to life insurance and annuities, these are the same types of things that apply; same types of things you can get when you go in to make a loan from the bank.

REPRESENTATIVE GANNON: Thank you. Just an observation. Somewhere in those papers that are signed and the settlement is actually finalized, there's usually a provision that says we're denying any liability, responsibility whatsoever, or any obligation at all to the claimant. However, to bring this matter to a conclusion, we're going to pay over a sum of money.

The view I see there is, we really don't care. We're not concerned so much about the hardship or the financial situation of the claimant. We're trying to resolve a dispute that the claimant has with our insured, assuming it's an insurance company, with our insured and we want to end the matter. So, this is how we're going to end it. We're going to pay over a certain amount of money that we've agreed to. We're going to do it this way.

It has nothing to do in our mind -- I'm not just speaking about an insurance company. I don't see where the insurance company really gives a wit about, I don't care about your financial hardship; I don't care about what you're going to do with this money. I don't care how you're going to handle this money. I want to end a dispute that is headed towards a courtroom and that's what I want to avoid.

So, I'm going to pay you a certain amount of money, but in those papers I'm going to specifically say, I don't have any obligation; denying any liability to you, denying any obligation, denying this ever even happened. However, in order to resolve our differences and get you to quit your claim forever, we're going to make this transaction that's going to be in the form of periodic payments.

MR. MARSHALL: On that sense --

REPRESENTATIVE GANNON: Then all of

a sudden I see insurance companies coming into a hearing like this and supporting a bill and now they have all these concerns about this poor claimant. Is he going to have a financial hardship? How much commissions he's going to pay? What the attorney fees are going to be?

It seems kind of ironic that on the front end they're just wanting to get out of court, resolve their differences by paying over an amount of money. And now on the back end the insurers have this great concern about the welfare of this claimant.

MR. MARSHALL: Couple points on that, Representative Gannon. That's a nice little aside you make, different people's views in the insurance industry, and I respect that.

One of the things, you can say all you want, hey, on the front end we had absolutely no concerns. You say, gee, all you want to do is deny liability, deny obligation. Be a little careful on the nomenclature there, because we're clearly not denying obligation when we're writing the check. Particularly when we enter --

REPRESENTATIVE GANNON: Oh --

MR. MARSHALL: Please. -- when we enter into a structured settlement, we are not only accepting an obligation, but we are accepting an obligation over an extended period of time.

Now, you can say, gee, you really didn't care about that claimant. You can say, here, you had absolutely no concern with him. You know what, maybe in our heart of hearts we didn't. But the fact is, we're heavily regulated. We are regulated to the point that we have to care about that claimant. We have to deal with that claimant fairly or else the Insurance Department is going to take a whack out of us. We have to deal with that claimant fairly or else the Plaintiff's Bar is going to take a whack out of us.

On the other hand, when the claimant is then a couple years down the road saying, gee, I saw an ad on the Jerry Springer Show about maybe getting into a factoring transaction, there's nobody there for him. There is no Insurance Department there for him. There is no Attorney General there for him. There is no Plaintiff's Bar there for him.

Are we concerned with hardship? Yes, we're concerned with hardship in a large part because we have a federal tax exposure. It's a potential disclosure.

We are also concerned -- And you can question my level of commitment to the consumer all you want. I think you and I have dealt with each other long enough to know that it is a genuine one on my part. I don't like to see anybody getting nailed. I don't like to see anybody getting hurt. I accept regulation of our industry to make sure that we deal with people fairly.

I think you need the same thing for the factoring companies. I think they ought to be subject to that same type of oversight. I said to Representative Hennessey, there are two ways you can do it. You can regulate the transaction itself, or you can regulate the industry. We're subject to a bit of both.

What we're talking about here is regulating the transaction. And you can say, gee, I can't believe the insurance industry is all of a sudden so concerned with consumers. I think we've dealt with each other enough to know -- hope you know that our interest is in doing that. We understand that there is a bigger picture beyond some hard and beam (phonetic; talking fast) aspect.

REPRESENTATIVE GANNON: What I was trying to say is that, this is a business transaction. I don't think we should lose sight of that while we're debating this bill. That's really what I'm trying to say.

The insurance company is not a social welfare agency, I recognize that, although they have corporate social responsibility and all those other good things. They are not social welfare institutions. This is a business transaction. You've cited that and you've come to the right conclusion. That's really what I was saying.

MR. MARSHALL: You're correct. From our perspective it is a business transaction and that's why we said, once our federal tax exposure is taken care of, we're out of the picture.

I do think that there is a good consumer benefit in all of this, which is why when I outlined other people who support the bill, you notice the Attorney General, the trial lawyers, disability groups, consumer groups, the Hospital Association, a whole lot of other groups.

You can say, boy, what a happy coincidence and what a convenient compilation of parties, maybe so. That doesn't undercut the value of the bill.

CHAIRPERSON CLARK: I think we'll move on. Mr. Marshall, you're welcome to stay up here and answer some more questions and have a seat there at the end.

We'd like to call three more gentlemen to testify before the committee: Thomas H. Countee, Junior, the Executive Director of the National Spinal Cord Injury Association; Randy Dyer, Executive Director of the National Structured Settlement Trade Association; and David S. Lowman, Junior, Esquire, from Hunton and Williams.

REPRESENTATIVE MICOZZIE: Mr. Chairman, is this going to be a two-day hearing?

CHAIRPERSON CLARK: No. We are going to move this rapidly along.

REPRESENTATIVE MICOZZIE: I just

thought I'd ask that question.

MR. LOWMAN: Mr. Chairman, members of the committee: My name is David Lowman. I'm with the firm Hunton and Williams. I'm a tax lawyer. I have represented a number of structured settlement companies, advising them on the tax issues associated with structured settlements. I'm here today on behalf of G.E. Financial Assurance, which is one of the largest issuers of structured settlement annuities.

MR. COUNTEE: Mr. Chairman, members of the committee: My name is Thomas H. Countee, Junior. I'm Executive Director of the National Spinal Cord Injury Association.

MR. DYER: My name is Randy Dyer. I'm the Executive Vice President of the National Structured Settlement Trade Association.

CHAIRPERSON CLARK: Why don't we start with Mr. Countee.

MR. COUNTEE: Thank you, Mr. Chairman. Good morning, Mr. Chairman, and other representatives. My name is Thomas H. Countee, Junior. I'm Executive Director of the National Spinal Cord Injury Association, a national nonprofit headquartered in Silver Spring, Maryland.

National Spinal Cord Injury Association has several chapters in Pennsylvania; in Monroeville, Altoona, York, and right here in Philadelphia, the NSCIA Delaware Valley SCI Association, whose president is Bruce McElrath. The Association's president is Jack Dahlberg who is a quadriplegic.

On a personal note, I have close connections to Pennsylvania. My paternal forbears lived in Philadelphia. My father taught for several years at Lincoln University in Lincoln, and I worked several summers picking berries in that town. My goddaughter lives in Philadelphia now, where I also own property.

Forty-one years ago in 1958, I sustained a diving accident on the Chesapeake Bay, rendering me a quadriplegic. I'm an attorney, and I served 15 months as legislative counsel in the Ford White House. It's a pleasure and an honor to come to Pennsylvania to testify on Senate Bill 818.

Today, I represent over 5,000 members of the National Spinal Cord Injury

Association and thousands of other spinal cord injured persons, many of whom benefit from structured settlements, including several hundred in Pennsylvania. The National Spinal Cord Injury Association has no business or tax effect stake in the outcome of this proposed legislation, Senate Bill 818.

However, the Association is deeply interested in the health, safety and welfare of persons with catastrophic, traumatic and/or debilitating injuries, many of whom are association members and receive structured settlements.

NSCIA is deeply troubled at the emergence of factoring companies that convince injury victims, including persons with disabilities, to sell structured settlement payments for a deeply discounted cash lump sum. Such transactions completely undermine the long-term financial security of a structured settlement and threaten the very livelihood of an otherwise extremely vulnerable population, those of us with disabilities. And the steep financial discounts that disabled Americans often are persuaded to accept would be unacceptable to any fair-minded person.

Factoring companies increasingly prey upon the weakest, most gullible and most vulnerable in our society. I assume that many of you have seen the television ads soliciting calls from those who have recently suffered severe injuries.

We believe that at present, the merging gray market of factoring companies is largely unregulated, unresponsive to the needs and best interests of recipients of structured settlements and unconscionable in their slick, high-pressure marketing practices and unethical legal maneuvers and stratagems such as the use of a confessed judgment against the victim in a distant court to garnish the victim's payments.

Senate Bill 818 focuses on protecting those covered by structured settlements, and protects the settlements themselves by matching federal proposals, as you heard earlier from Mr. Marshall.

I have come here to let you see the type of catastrophic injury affected by this bill and to put a human face on this legislation; not as a beneficiary of a structured settlement myself, but as a leader of and advocate for severely disabled persons who have. In 1982, the intent of the Congress, the social purpose if you will, was to encourage those who receive monetary settlements growing out of catastrophic injuries, to accept periodic payments to safeguard the uncertain futures they face.

Factoring companies' intent, on the other hand, is simply to cheat severely injured persons out of their money. The goal of Senate Bill 818 is to protect consumers by regulating factoring transactions and companies, not putting them out of business. However, Senate Bill 818 does nothing to help those who have already been taken advantage of. We need this legislation to guide those who may be taken advantage of in the future.

You can and should stop this outrage. Sound public policy and simple decency would indicate that as legislators, you have no choice but to do the right thing.

For all these reasons, the National Spinal Cord Injury Association respectfully recommends and strongly urges your support of

Senate Bill 818, Pennsylvania Structured Settlement Act, which would provide needed protection from the predatory practices of these factoring companies. Thank you.

Thank you very much for the time and attention you are devoting to this critical issue and the opportunity to appear before you. I will be happy to answer any questions you may have about the association or our interest in this matter.

CHAIRPERSON CLARK: Thank you very much. Mr. Dyer.

MR. DYER: Thank you, Mr. Chairman, members of the committee. I believe Sam did a great job of sort of teeing up the issue, but I couldn't help feeling as I was listening there was some gaps in understanding. It is a complex affair, so I thought I would devote my time to filling in some of those gaps for you.

First of all, structured settlements are essentially a creature of Congress. Structured settlements have been used for 20 years, but they were codified in the Federal Tax Code in 1982. Congress did that because, in 1982 they saw the confluence of two social trends. The first was the great society programs in the 1960's. The second was the first million-dollar judgment in settlements in the 1970's.

What Congress came to realize by 1982 was that, people were receiving large lump sums in settlement or judgment from large physical injury accident cases, and regrettably, they were unable to make that money last a lifetime in many cases, as it should to provide for the needs of the individual.

I can assure you that any trial lawyer can tell you stories from their own experience about people who received large lump sums and through improvident spending or bad investments have been unable to make the money last.

So Congress said there's got to be a better way. In 1982 they passed the Periodic Payment Act, which was intended to encourage people to take money over time. They did so through, unfortunately, the awkward means of the tax code. What they said was, we want to encourage people to take money over time and we're going to do so by forgiving them from paying tax on the future stream of payments even though the future stream of payment has both a principal and an interest component.

In other words, if you receive a lump sum in settlement or judgment, you would receive that tax free. You take that same lump sum and purchase a funding stream which you receive over time, you would receive every one of those payments as a capital payment. It's a significant tax advantage. That tax advantage has encouraged the growth in the use of structured settlements.

I heard earlier some discussion that structured settlements are expanding widely or that they are used in 90 percent of the cases. I want to ensure you that that's just not true.

Insurance Service Office does a study called the Closed Claim Study, which is produced every two years. The most recent is 1997. The latest one is not out yet. What that shows is that, currently, structured settlements are used in just over 12 percent of physical injury cases. These are the larger cases. These are the ones over $70,000.00.

If you break that number down, you

see that in the smallest of the cases in the study, that is those over $70,000, structured settlements are used in around five percent of the cases. As you go up the line to cases that settle or are adjudicated over a million dollars, structured settlements are used in 20 percent of the cases. Obviously, structured settlements as they are intended are used in the larger, more catastrophic kind of cases.

What the study shows you over time is that, structured settlement, the use of structured settlements was growing because it is a meaningful way of settling these large cases. But in the very recent study we saw a different use of structured settlements for the first time.

We obviously were concerned about that as a Structured Settlement Association. What we found when we looked into it was that, trial lawyers are telling us, we love structured settlements. We think structured settlements when they are right, and they're not right in every case, but for the right set of circumstances a structured settlement is a very good thing.

But because these factoring companies have come along, because people are being taken advantage of, I don't want to put them in a structure because they are going to lose half of the money to factoring companies. I would rather give them their lump sum and let take their chances that way rather than see them lose their money later on.

We're concerned that if the factoring companies are allowed to continue doing the things that they are doing, that we will lose the use of structured settlements and they are an important means of settling these kinds of cases.

They're also, and I think somewhat alluded to it earlier, I think an important safe harbor in the tort-reform wars. I know that this committee has heard arguments between the insurance industry and the trial lawyers on various issues before, but you'll find they're unified on this subject. Both sides like the use of structured settlements. Again, when they're right, they're right.

Now, I also wanted to talk a little bit about how factoring transactions work.

First of all, when you receive a structured settlement -- Let's assume you were injured, Mr. Chairman, and that you were going to settle your case. As Sam said, you would have a choice. You could take a lump sum to settle the whole matter and close it, or you would take -- I don't believe anybody ever takes a pure structured settlement; that is, payments over time, although they're referred to that way.

In fact, in the ISO studies they say that structured settlements normally represent only 48 percent of the settlement. Half of the money is always paid upfront in cash, and there's two good reasons for that. First of all, you have to take the attorneys' fees out of that upfront in cash. Attorneys aren't taking their money over time.

Secondly, you, normally by the time you've come to achieve a settlement, have some economic damages from the past that have to be resolved so you need to settle those in cash.

The payments you take over time then would represent normally a little less than half of the amount you settled for.

The present value is not the

operative issue in a structured settlement because you have a better number than that. You have the cost. That payment stream out over time has a cost. If you're going to purchase it, you're going to purchase it at a cost. And that cost is the most important judgment of what the value is. It's the most important way to judge the value simply because it's the basis on which the plaintiff attorney is going to take their fee.

Normally, these cases, they're contingent fee cases and the attorney has to know how much the settlement is for. So it was for a combination of a lump sum plus the cost of the payment stream out over time. Those two numbers together represent the cost of the settlement.

There's no gains with present value. There's no sort of hiding the ball. You have to know what the structured settlement costs in order to close the case so that the attorney can take their fee, unlike the factoring transaction where you always use this sort of mythical present value, based on some mythical interest, great assumption.

Now, in my case you're receiving a structured settlement. Let's assume you are receiving a structured settlement paying you $2,000 a month. As a factoring company, I would come to you and I would say, I'd like to buy $500 of your 2,000 a month. There's a reason I don't want to buy your whole 2,000. I'll just buy a piece of it. We'll get to the rest of it later on.

So I'm going to offer you a lump sum and you accept that and you sign my contract. I say to you, now listen, I don't want G.E. to know that we've done this because you signed a contract with G.E. saying you wouldn't sell it and now we're going to do it. So we're going to keep that quiet from them.

You send them a change of address. They'll then send your check to me in your name. I then, as part of my contract, have taken power of attorney over that check. I'll cash the check. I'll keep my 500 and send you your 1,500.

Now, why didn't I buy the whole deal? Because, as part of my contract--and these contracts are fairly standard in the factoring business--I've also taken the right of first refusal against any -- you selling any future payments. I also control your check, so if another factoring company wants to compete to buy the second 500, they can't because I control your check, so they won't compete for it.

Now, if you want to sell the next 500, and you probably will because you've got 25 percent less income coming in and you dissipate the money that I've given you, so you need another lump sum, now you have to deal with me. Well, I may have given you a 20 percent, maybe 30 percent discount on the first one, but I don't have to be that nice to you on the second. I can charge you 50 percent on the second.

As you'll see in my handout, we've analyzed a hundred fifty of these transaction. The average discount on these transactions approaches 30 percent.

Now, the factoring companies also know that at any point you could call up G.E. and say, send the check back to me, and they would because they're going to send the check wherever you want them to. My problem as a factoring company is that, then I lose my control over you so I need something that's going to help me get that control back. And that, as Mr. Countee said, is this confessed judgment.

Each of the companies does it a little different. The largest company here in Philadelphia, J.G. Wentworth, uses confessed judgments because confessed judgments are legal in the State of Pennsylvania. However, they're not legal in consumer transactions. So, as a part of my contract, I have gotten you to agree that this isn't a consumer transaction.

Now, if you were to try to transfer your check back to you, perhaps you'd transfer it back to you and pay me my 500 anyway. It doesn't matter. If you transfer your check back to you, I'm going to hit you with that confessed judgment. I'm going to go into Philadelphia court and I'm going to hit you with this confessed judgment.

Once I have the judgment, then I can go to G.E. and I can send that judgment against this guy. Now I want to garnish the payments. That locks in the transaction. Now you can't do anything about it. Now I own that money.

With the factoring transactions we're offering a legitimate service. Why wouldn't they do it the way the banks do it? Why wouldn't they say to you, I'll give you a lump sum and you pay me a check every month? You get $2,000.00. That's good money. You're getting it from one of the largest financial institutions in the world. When you get your check, write me a check for 500 and we'll be fine.

They don't do that because they're not doing you a favor. They want to reach back and grab that money at its source from a highly-rated financial institution. So, they use these techniques to get control of your money. That's what they're doing here.

If you take a look at the U.S. News and World Report story, which is part of your handout, you'll see other faces on this tragedy. The very first person looking at you is Jerry Magee, a Mississippi workers' comp recipient. Jerry Magee sold his workers' comp payments even those it's illegal to do so in Mississippi. In fact, it's illegal to do so in all 50 states, including Pennsylvania.

Factoring companies buy the transaction. Why? Because even though it's illegal, these laws are not self-enforcing. Jerry Magee would have to raise that as an affirmative defense. Once Jerry Magee loses his money, he has no way of representing that defense.

The next picture you look at is Christopher Hicks, a teenage quadriplegic.

The next picture you look at is I think the most tragic, Raymond White. Raymond White was living homeless on the streets of New York for seven years. He was involved in a subway accident, and as a result, received a structured settlement. With that money Raymond White turned his life around. He was married. He now has a five-year old child, apartment in Queens. Raymond White regrettably also has an 8th grade education.

J.G. Wentworth did five factoring transactions. Over the course of five factoring transactions they took everything that he had. Raymond White now lives on public assistance and the charity of Abbottstein (phonetic) Baptist Church in Queens.

The last picture you're looking at, Davinia Willis, a teenage paraplegic. These are the people that are being victimized by these transactions.

If you look behind that, you'll see the report of a study that we've done on factoring transactions. As I said, these transactions are essentially done in the shadows. There's no regulatory authority overlooking these things. There's no public record on these things.

But we found a public record in courts because the factoring transactions -- perfect their transactions by suing people. Go down Philadelphia courthouse right now, you'll find that G.J. Wentworth is involved in 400 confessed judgment actions, lawsuits against their own clients right now.

Settlement Capital that operates in Dallas, 70 in Dallas court. Singer Asset Finance, which uses a court in New Jersey--although they're Florida based, they use a court in New Jersey--150 of these transactions. Peachtree is the newest in the business; also Norcross, Georgia. They use a court in New Jersey. I don't know why. They have 40 or 50 of these lawsuits against their own customers.

From those court records we've been able to determine a great deal about how these factoring companies work. And the report of that study is in your book.

If you follow each of the transactions over, you'll see the number of payments sold, the amount of the payments, when the payment is due, the total amount of the payments, the true present value of the payment stream as computed using the Treasury's -- the federal rate which has to be used to make that determination published monthly by the U.S. Treasury; the present value, then the contract price actually received from the court records.

The next column is the contract price as a percent of present value. You go down through the whole list you'll find that people are receiving less than 50 percent of the true present value of their future stream of payments. Look at the discount rate that they are charged.

We call it a mortgage equivalent

interest rate because I think it helps clarify what this transaction is. I'm giving you a lump sum and you're paying me back with your future stream of payments. That's very much like a mortgage loan.

If this were a loan, what interest rate would it bear? If you go down that list, you see 36.2, 19.8, 24, 36. These are the annual interest rates that the victims of factoring companies are paying to the factoring companies. And on average, that's over 28 percent per year that these people are paying the factoring companies.

The next column is the internal rate of return, the factoring company. How much are they making on the money that they put out. You'll see that that number runs well into 30 percent per year. Factoring companies have a lot at stake here.

You will also notice in the last column the names of the factoring companies who are involved in the individual transaction. J.G. Wentworth's name appears on almost half because they are by far the market leader.

Finally, we've summarized some

individual cases; some of them are cases from Pennsylvania, some of them from around the country. I want you to take a look for a moment, the case of Alison Grieve, the third one back in your package. Alison Grieve did a deal with Singer Asset Finance. When Singer went into court with Alison Grieve, they submitted as part of the court record Alison Grieve's original application to them, so it became part of the court record.

There's a question and answer that's listed in there. They asked Alison Grieve what was her total annual income. And her answer was 12 times $1,021.00. Her total income was her structured settlement payments. They said, do you rely on those payments? She said yes. Then they said, well, what are you going to do after we buy your payments from you? She said Social Security would be applied for at that time. Medicaid is paying her other costs.

Now, I refer you to the quotes in the back of the book there from United States Judge Sessions which he adjudicated in Vermont. This quote comes from Judge Sessions' opinions. Page 4 of those quotes, the judge says:

In conclusion, as Grieve has stated, she is currently in substantial financial need. The court is asked to enforce a transaction which will place her in significantly greater need by cutting her income stream in half over the next 15 years. Grieve, like any other citizen, is free to make arrangements which this Court might deem unwise. But this Court will not lend its approval to the voiding of unambiguous, bargained-for contract terms in order to enable Singer to profit at an exorbitant rate of interest from Grieve's financial distress.

Thank you for your time. If there's any questions I can answer, I'll be happy to do so.

CHAIRPERSON CLARK: Mr. Lowman.

MR. LOWMAN: Thank you. Mr. Chairman, members of the committee: I'll talk to you a little bit about tax issues. I'll be brief because I suspect your tolerance for federal taxes is probably low at this time.

But before I get into federal taxes, let me hopefully bring structured settlements home to you a little bit.

The Pennsylvania CAT Fund, which you are all aware of, settle somewhere in the neighborhood of a hundred million dollars in claims per year. It structures approximately forty to $50 million of those claims each year. As the administration of that fund has changed between parties and so forth, they have always -- both parties have looked at structured settlements as being a very good way to settle those cases and provide for the long-term benefits of injured parties.

So, the CAT Fund here in Pennsylvania is doing forty to $50 million a year in structured settlements.

Recently, one of the factoring companies has filed a Freedom of Information Act request for all of the names of the recipients of structured settlements from the CAT Fund. I'll leave you to conclude what they might do with that list of parties if they are able to get it.

But, let me talk about the federal income tax consequences. We can't avoid talking about federal income tax consequences because, while there are the public policy reasons to settle cases on a structured basis and provide long-term benefits, they're structure and means of doing that is provided for in the Internal Revenue Code. Payments are usually made for the life of the claimant.

Under the Internal Revenue Code, I think, as Sam said, claimants get periodic payments tax free. The difference is that, if a claimant were to settle for a lump sum, take the lump sum and invest it, the interest or other income he would earn on the lump sum is taxable. But, if he takes a structured settlement, the lump sum is, in effect, invested on his behalf in an annuity, and that income that builds up in the annuity is tax free. So, the injured party gets a very significant tax benefit by avoiding tax on the income component of the lump sum amount.

In addition, the structured settlement company gets a very significant tax benefit. The structured settlement company, which is the company that assumes the obligation to make the periodic payments to the injured party, will receive a lump sum amount, which is usually the purchase price of the annuity, from the casualty company. The full amount of that lump sum amount received by the structured settlement company is excludable from income provided provisions of Section 130 are satisfied.

Section 130 says that, in order to get that very significant tax break, the payments cannot be accelerated. As the IRS recently said in a letter ruling, the payments cannot be freely transferable. To prevent the free transferability of those periodic payment rights, almost universally settlement agreements provide anti-assignment provisions.

In addition to the inability to accelerate payments or to freely assign them, the payments must be excludable from the income of the recipient under Section 104. Now, the factoring companies will probably get up here and tell you that there is no federal tax -- no adverse federal tax consequences from factoring transactions. And they're likely to show you the opinion from Price-Waterhouse-Coopers that says that there should not be any adverse tax consequences.

And they will also show to you a

private letter ruling issued by the Internal Revenue Service which came out just about one month ago that says that there are no adverse tax consequences to a claimant; that is, the injured party, from a factoring transaction.

A couple of things about both the opinion and the P.O.R. First of all, the opinion is just an opinion. We have to look at and make our own assessment of what the risk is, and we have done so. We believe that there is, in fact, a significant risk to the structured settlement companies and insurance companies that issue these annuities. And the current U.S. Treasury Department has said so.

Just last week there was testimony before the House Ways and Means Committee in Washington, and the issue of the private letter ruling was raised by Chairman Archer. Chairman Archer asked the Assistant Secretary of Tax Policy, Donald Lubick, about the private letter ruling and asked him: Can we ask Treasury's help in getting some formal guidance on the income tax consequences of factoring transactions for both the beneficiaries and the providers of structured settlements?

And Secretary Lubick answered: It is unlikely that we can give guidance with respect to other parties to the factoring transaction; that is, other than the injured party. It is very hard for us to construe the statute to resolve that to give some favorable tax treatment that is being sought by these other parties.

In other words, Treasury is saying that there is, indeed, a tax risk to the structured settlement companies where these factoring transactions take place. That is because the clear terms of Section 130 of Internal Revenue Code are not complied with.

One example. One of the requirements that I mentioned was that the payments must be excludable from the income of the recipient under Section 104. If those payments have been assigned to a factoring company, they're not excluded from the income of the factoring company under Section 104, so you've got a clear violation in terms of Section 130.

If the terms of Section 130 are violated, the potential tax consequences to the structure settlement company is that the full amount, the full cost of the annuity that has been excluded from income under Section 130 is potentially includable income. That's a very, very significant risk to the structured settlement companies.

So, despite what you might hear about there not being tax risks, you've got statements from the Treasury Department that tax consequences are in fact unclear, and it does not look like they can give a favorable answer to the structured settlement companies. We have to look at what the current Treasury Department, which is over top the Internal Revenue Service, has to say and evaluate that risk.

We think that the bill that's before this committee would take care of the tax risk to the structured settlement companies if transfers are approved in accordance with the terms of the bill.

I'll be happy to answer any questions that anyone might have.

CHAIRPERSON CLARK: Representative Washington.

REPRESENTATIVE WASHINGTON: Thank

you, Mr. Chairman. I have a couple questions. I'm a little confused in some of the comments. I got here late, but I'm pretty much familiar with this because my daughter is a victim of this.

What I want to ask you, first of all, is that, if a person is given a hundred thousand dollar settlement with this attachment to it, do they have an option not to take that, or is that mandatory?

MR. DYER: No, no. Absolutely. Structured settlements are always privately negotiated. Courts can't order structured settlements.

REPRESENTATIVE WASHINGTON: Can insurance companies do that in the settlement?

MR. DYER: No. Absolutely not. Not unless both sides agree.

REPRESENTATIVE WASHINGTON: If a person is awarded a hundred thousand dollars in a structured settlement and they're given, say, $50,000 because, of course, the lawyer has to get his money and all the medical, if I'm clear, bills have to be taken care of, so the person only winds up with what's left of that $50,000;

is that right?

MR. DYER: That's correct.

REPRESENTATIVE WASHINGTON: The other $50,000 is suppose to be given to the person over a period of time; is that right?

MR. DYER: If that's what they agreed to, yes.

REPRESENTATIVE WASHINGTON: In the end, when you add up the amount of money that they receive in a lump sum and the amount of money that will be given to them over a period of time, would it come up to a hundred thousand dollars?

MR. DYER: It would come up to much more than a hundred thousand dollars.

REPRESENTATIVE WASHINGTON: Who gets the interest on the money?

MR. DYER: The individual who is receiving the money. That's why it's more than a hundred thousand dollars.

REPRESENTATIVE WASHINGTON: So, you're saying to me that if a company agreed to be the benefactor or the distributor -- What do you call it? Tell me the right word.

MR. DYER: Annuity provider.

REPRESENTATIVE WASHINGTON: The annuity provider. The annuity provider doesn't get the interest? The person whose money it is gets the interest off that money.

MR. DYER: That's right. They would receive the interest on the annuity. As I say, each annuity payment would contain a principal and interest component. It's the interest that they're receiving on each payment, the tax on which is forgiven.

REPRESENTATIVE WASHINGTON: If the person came into a hardship, and I guess some of the stories that you read to us earlier were those people who had those kinds of problems, if they wanted to go back and borrow some money out their of own annuity, that they were penalized for that. Is that what I heard you say?

MR. DYER: No, ma'am. If I understand your question, if you were receiving money over time, the Chairman was receiving $2,000 a month; if the Chairman wanted to come back to the annuity provider and say, this month I'd like to get $10,000; unfortunately, the annuity company would have to say no.

It's because of the way Congress

structured the thing. By saying, look, you cannot accelerate. You cannot defer. You cannot anticipate. You can't sell these things. The tremendous tax advantage that you get with a structured settlement would be destroyed at the point in which the life insurance company did that.

Now, if the life insurance company, the annuity company could do that, they could replace the factoring companies, which they could do in a regulated way. But they can't, so they don't.

REPRESENTATIVE WASHINGTON: But suppose a person had a hardship where they, whatever, needed the money right then and there and they were willing to forbear --

MR. DYER: What normally happens in those circumstances, and we've seen, as a structured settlement industry, we've seen those kinds of hardships come up fairly and frequently up until the factoring companies started their advertising blitz, but they did come up.

When they do, what will happen is, a company like G.E. will work with the person and say, look, go to the bank and tell them that you need this money for whatever reason. You're getting $2,000 a month from G.E.

Now, that payment in your structured settlement is frankly better than having a job from a bank's point of view because you can't get fired from your annuity payment. They're going to make this payment to you for the rest of your life come hell or high water.

From the bank's point of view, you're getting $2,000 a month from a highly-rated financial institution is pretty good collateral for the loan. So, normally, people can work these things out.

REPRESENTATIVE WASHINGTON: You're saying it would be better for the person to go get a loan from the bank?

MR. DYER: Far better. Far better. Banks in Pennsylvania, at least I'm sure, are not charging people 35 percent per year interest rates. So, they would be far better off.

What the factoring companies have done is create their own market with this blitz of cable television advertising, websites, and buying lists, and trying to get lists through court deals so they can call people.

J.G. Wentworth has 200 telemarketing stations in New Jersey that operate 24 hours a day. You can bet that the pressure is on these people to sell their payments. That what's happening here.

REPRESENTATIVE WASHINGTON: Thank you. Thank you, Mr. Chairman.

REPRESENTATIVE GANNON: Representative Hennessey.

REPRESENTATIVE HENNESSEY: Thank you. I'm trying to understand this. Is it the acceleration feature of the payments, the acceleration of the payments to the ultimate recipient, the claimant, in a lump sum that triggers the adverse consequences under the Internal Revenue Code to the structured settlement company?

MR. LOWMAN: I think that's right, because you've got a number of requirements that are set out in Section 130 of the code. In order for a structured settlement company to be able to exclude the full amount that it receives, all those provisions have to be complied with. Those provisions include the restriction that the amount cannot be accelerated and so forth.

There's also a requirement that the claimant not have the present economic benefit of the amount, which is a way of saying that the right he has to receive future payments cannot be freely transferable. There's also a requirement that the payments must be excludable from the income of the recipient under Section 104 of the Internal Revenue Code.

If you've got a factoring transaction where the right to receive payments is transferred to a new recipient, i.e., the factoring company, then the factoring company is not able to exclude the amount under Section 104, then you have violation of the terms of Section 130. If you violate the terms of Section 130, that causes an adverse tax consequence, or could cause an adverse tax consequence, I'm sure, of itself.

REPRESENTATIVE HENNESSEY: Since the claimant is getting a lump sum in every case after a factoring transaction, almost by definition it would seem that an acceleration of at least some of the payment has occurred. Why can't you tell us that yes, there is an adverse tax consequence? You're saying there may or may not be. Either it seems to me it is or it isn't unless the IRS hasn't been involved.

MR. LOWMAN: The IRS has not issued -- There have been no rulings in the area. We've got statements from the Treasury Department saying that they think there are risks to the companies. You can look at the Internal Revenue Code provisions of Section 130, (coughing; inaudible words) very clearly that these transactions would violate the terms of Section 130.

These transactions have only been going on about four or five years with the increase in the amount over that period of time. It takes the IRS awhile to, you know, conduct audits, and so forth and so on. You can't expect for it to --

REPRESENTATIVE HENNESSEY: At some point in time -- I'm sorry. Go ahead.

MR. DYER: I'm not a tax expert I hasten to say, but let me speculate a little bit here. I think that one of the reasons the IRS hasn't dropped the hammer on this thing is because the hammer has to strike the fellow in the wheelchair first. The problem is, if the tax treatment for all the parties in these transactions has come unraveled, then they've got to go after that individual in order to get to the annuity company. They don't have the summon to do that.

REPRESENTATIVE HENNESSEY: I thought the private letter ruling said they're not going to do that.

MR. DYER: Exactly. As you heard from David, I think that private letter ruling was their way of saying, we don't want to drop the hammer on this guy, but we're not going to tell you that the annuity company doesn't have a problem. I think it's kind of a tortured logic. You would think, gee, if you're going to say nobody has a tax problem, then nobody has a tax problem. But they didn't say that.

REPRESENTATIVE HENNESSEY: Second thing, you told us that in order get to the annuity company you've got to get the ultimate recipient, and the letter ruling would suggest that they may not go after that ultimate recipient, but they still can come after the tax --

MR. DYER: Regrettably it is tortured logic, but that's what private letter rulings sometimes are. The problem is, a company like G.E. sells structured settlements based on tax certainty. Absent tax certainty they won't sell a structured settlement.

REPRESENTATIVE HENNESSEY: And the acceleration is the triggering mechanism for the adverse tax consequence.

MR. DYER: That's right.

REPRESENTATIVE HENNESSEY: Under either proposal we have in front of us, you would be in a sense getting judicial sanctioning for some acceleration of the structured settlement. The whole purpose of these bills is to say, if you want factoring service, take a discounted figure, go to the court and get permission.

MR. DYER: That's correct.

REPRESENTATIVE HENNESSEY: It would seem to me, whatever standard we set, doesn't change the acceleration of the money to the ultimate claimant and, therefore, there may be an adverse tax consequence. Or, are you telling us that that's the purpose of this proposed regulation out of the Treasury?

MR. MARSHALL: Representative, if you notice what the Treasury Department is saying right now is, look -- And you can tell this because this is what they have proposed. They've said, we'll allow for this acceleration or this factoring, or whatever you want to call it, we'll allow for that if there is a financial hardship showing.

REPRESENTATIVE HENNESSEY: So they'll move away from the acceleration and they'll say, we'll just ignore it if there's financial hardship.

MR. MARSHALL: If there's financial hardship. What we're saying here for Pennsylvania purposes is --

REPRESENTATIVE HENNESSEY: Sam, do we have the power in Pennsylvania to fashion that standard? It would seem to me, since it's an Internal Revenue question, it has to come ultimately from Washington.

MR. MARSHALL: No. That's why -- I mean, understand what the Internal Revenue Service says, as long as the court. There they mean any Court of Common Pleas, in any given jurisdiction, in any state, so long as the court shows -- So long as the court determines that there's a financial hardship, then you can do it without any tax problems and then they'll allow for it despite what the Internal Revenue Code currently says. So, we have the power to do that.

Actually, what this bill says is, if the feds do some other standard than financial hardship -- The Treasury Department which right now says we want financial hardship, if the Treasury Department two years from now or if the U.S. Congress two years from now says, no, you know what, we don't mean that. We mean some other standard. Then that's the standard that would apply here in Pennsylvania.

REPRESENTATIVE HENNESSEY: What's the current standard? You're telling us that financial hardship is the proposed Treasury Department's standards.

MR. MARSHALL: Right now there is none.

REPRESENTATIVE HENNESSEY: The county said there was a federal proposal. Is there any standard at all?

MR. MARSHALL: No. Right now there is not standard. What we're talking about here is dealing with a loophole that's been created. It's like any other loophole that's created. There's no standard that applies to it. That's by definition a loophole. What you're dealing with is, we're faced with a potential tax concern.

Frankly, I don't think the Treasury Department wants to go after us. Its first goal is to say, here, we want to put some restrictions, some limits, some fairness on what factoring transactions are. That's what you see here. We're only going to allow -- We understand the loophole. We're only going to allow it to exist if there's a hardship showing. That's what we want. If there isn't, we want a 50 percent or 40 percent excise tax.

What they're saying is, here, we'll allow for these structured settlements to be accelerated, cashed out, whatever term you want to use. We'll allow that if there's a showing of financial hardship. That's what this bill has.

Now, if the Treasury Department goes

with something else, or if the Congress goes with something else, this bill automatically defers to that.

What we are asking for is, who knows how long it takes Washington to act. What we're asking for is a safe harbor in that interim period. It also works to protect the consumer because there are consumer protections in this bill, but from our perspective, it's a safe harbor.

REPRESENTATIVE HENNESSEY: What would be the ultimate effect if our legislature passed this not with a financial hardship standard, but with the best interest of the claimant standard? Would that set us up necessarily -- It wouldn't set us up in competition with the federal government because the federal government has no standard now.

MR. MARSHALL: And you know what the problem is?

REPRESENTATIVE HENNESSEY: Wouldn't you still also have a court determination that this is in the best interest of the claimant so IRS, perhaps, could defer and say we won't chase these people?

MR. MARSHALL: Maybe they would, but right now you have the Treasury Department saying, no, we want it to be financial hardship. Why would you do something other than this?

The IRS looks and says, we want it to be financial hardship. That's what we propose. Pennsylvania, you did something less than that. Presumably, there's some cases that, if you had showed best interest, some cases there's also going to be a financial hardship. But some cases there isn't. Why would we in Pennsylvania want to set up a standard that's different from what the Treasury Department has said in this area? It doesn't make any sense.

REPRESENTATIVE HENNESSEY: The Treasury Department speaks for itself I suppose. The government and the Congress hasn't set a standard yet.

MR. MARSHALL: You're right. The Congress hasn't. That's why this bill says, look, if the Congress does something less than financial hardship; if it does something less than best interest; if it says, you know what, we're not going to do anything at all, that's what this bill would do. It would go right away to whatever Congress enacts.

But in the interim, given the tax exposure that we have, doesn't it make sense to go with what the Treasury Department is proposing? If something different than that is ultimately enacted, this bill automatically jumps over to that. But until then, why not stay with the only proposals that are out there on the table from the Treasury Department and the U.S. Congress.

REPRESENTATIVE HENNESSEY: It would seem to me that there's a real tug of war between that standard. Forgetting about acceleration, because that's IRS, the question is going to be, will the IRS turn its back on the acceleration if somebody has gotten court approval? The answer seems to be yes, we expect that they will.

Now the question is whether or not that court approval should be based on the best interest of the claimant or on financial hardship. I guess to some extent there may be some flexibility in financial hardship, setting that as the standard.

Couldn't we structure the bill to

say that if we believe that the best interest of the claimants are served; that that be the standard, and if the federal government ultimately through their Congress sets the financial hardship, we would move up to that?

MR. MARSHALL: You know what, you could do that. Then what you're talking about is, in the interim, what level of protection are you getting? Right now we're looking at saying, the Treasury Department is saying this. It may or may not be prevail.

REPRESENTATIVE HENNESSEY: Let me address that question. Mr. Dryer, how many of these cases that you outlined for us in your grid, in your testimony would fail under the best interest standard?

MR. DYER: I have no idea.

REPRESENTATIVE HENNESSEY: Well, 35, 38 percent on average? Wouldn't they be deemed to be a violation of the best interest of the claimant in that situation?

MR. DYER: You mean in terms of the deal people are getting?

REPRESENTATIVE HENNESSEY: Yes.

MR. DYER: Yes, I would think any

court would take a look at those kinds of terms and say this is outrageous. Your question is, what was the need of the individual who fell victim to the factoring company? The answer is, there's nothing in the court record to answer that question, address it. The standard goes to the financial hardship of the individual.

MR. MARSHALL: Right now there is no standard.

REPRESENTATIVE HENNESSEY: There is no standard. You're saying the standard that you would advocate.

MR. DYER: The standard that you're discussing, the standard the Treasury proposes.

REPRESENTATIVE HENNESSEY: Quite honestly, I guess I'm still confused as far as when financial hardship and best interest of the claimant would be somehow different standards. You're saying now, Sam, it's lower or, perhaps, even substantially lower, but before when I asked to give an example, it seemed hard to figure out what the difference was.

MR. MARSHALL: No, no. I didn't -- Representative, let me get a couple points clear. There have been a couple of things here where maybe you jumped from one point to another.

REPRESENTATIVE HENNESSEY: The water is really muddy in my mind now.

MR. MARSHALL: I never said that best interest is substantially lower.

REPRESENTATIVE HENNESSEY: A second ago you said why would we want to advocate a lower standard.

MR. MARSHALL: A lower standard. There's a big difference between substantial and lower standard. I can't give you every factual parameter on where it might be different. All I'm saying is, it makes sense to go with what the Treasury Department is going with until something is resolved.

Now, right now understanding, you asked Randy Dyer what's going on, can he tell you from the grid which of them would be best interest, which of them would be financial hardship, the answer is no.

Right now there is no standard. There is no court approval. There are no disclosures. There are no protections whatsoever to any consumer when that consumer is solicited by a factoring company. There is absolutely zero regulation of the factoring industry, of factoring transactions of what goes on there. There is absolutely no oversight.

Now, what Senate Bill 818 does is set forth parameters. It sets forth some level of oversight and regulation of safety for the consumer and for the insurer when those things happen.

You may say, gee, I think the financial hardship standard is too tough. I think it's a little too much. I want to go with the best interest deal. You know what, I'm not sure, philosophically, I have some huge argument with you that I think financial hardship is better, and I might not fall on the sword. But I would say, gee, you know what, that's what the Treasury Department is suggesting to maintain that tax-exempt status. Why would you alter from that?

REPRESENTATIVE HENNESSEY: Well, perhaps in the same way you suggest earlier that the laboratory for change in the HMO regulation industry, the state did it first and set the standard because the federal government hadn't gotten around to it. It seems like we're in the same situation here.

The question we have to answer is, and maybe ultimately in the legislature, what that standard ought to be. If 40 states out of 50 decides on one standard as opposed to the others, then maybe the federal government will take a lead from us and not vice versa.

MR. MARSHALL: Maybe we will. Unfortunately, it's our tax liability that's on the hook as you go through that laboratory. We're the ones with the problem with the Treasury Department.

REPRESENTATIVE HENNESSEY: Thank you. Thank you, Mr. Chairman.

CHAIRPERSON CLARK: Representative Gannon.

REPRESENTATIVE GANNON: Just briefly so I understand this. If I'm a claimant and I have a 500,000 dollar -- let's suppose the cost of the claim is 500,000, and I'm told by the insurer -- I'm trying to be brief here. I'm told that over 30 years we'll pay you $1.4 million. That will cost $500,000.00.

On the other hand, I'm an investor.

I have $500,000 in cash and I think, do I want to buy an annuity for $500,000? Over the next 30 years I'll get paid back $1.4 million. From the annuity company standpoint, are they going to have the same tax consequence, or will one have a no-tax consequence and the other one will with that 500,000 dollar payment?

Do you understand the question?

MR. LOWMAN: If the claimant just purchases his own annuity for $500,000, the tax consequences to the annuity issue are the same because in either case the annuity issuer has sold an annuity and has premium income of $500,000.00.

The difference here is the structured settlement company which is set up to own the annuity. It's set up for tax purposes to own the annuity. It receives the $500,000 and then it turns to the life insurance company, generally an affiliated company, and buys the annuity for $500,000.00.

REPRESENTATIVE GANNON: Let me just for purposes of clarification I guess, if I took that $500,000--I'm just a person who wants to purchase an annuity--and I go to a structured settlement company and say, here's $500,000; find me an annuity that's going to pay me $1.4 million over the next 30 years.

Would that have a different tax consequence for that structured settlement company than if an insurance company wrote a check for 500,000 as part of a structured settlement agreement?

MR. LOWMAN: Generally, the claimant wouldn't come to the structured settlement company under the example. I'm not sure what point you're trying to get at.

MR. MARSHALL: You know --

MR. LOWMAN: Tax consequence through --

THE COURT REPORTER: Excuse me. I need one speaking at a time.

MR. MARSHALL: Representative Gannon, I think --

REPRESENTATIVE GANNON: Wait a minute. Let him finish.

MR. LOWMAN: If you've got a structured settlement, then it's set up for a specific purpose and you've got the structure. The reason this is structured this way is because the structured settlement company is the owner of the annuity because, if the claimant is the owner of the annuity, then the claim is going to be taxed on the income.

So you have a structured settlement company that's the owner of the annuity and then the claimant is not taxable on the income that's being earned on the annuity. That's the sole purpose of having the structured settlement company there.

REPRESENTATIVE GANNON: So what you're saying, the structured settlement company is really a creature of the tax code.

MR. LOWMAN: Absolutely.

REPRESENTATIVE GANNON: Prior to 1982 --

MR. LOWMAN: Yes.

REPRESENTATIVE GANNON: -- the insurance company would literally go into the market and buy their own annuity from another insurer.

MR. LOWMAN: The way those deals were then done were, the casualty company would purchase the annuity and would own the annuity. As long as the casualty company was the owner of the annuity, then the claimant wouldn't have income on the periodic payments. Or, there was some circumstances in which the government might buy the annuity and own the annuity. It's generally what it was.

REPRESENTATIVE GANNON: It seems to me that with this private letter ruling that these types of transactions have no-tax consequence for the claimant. It's more probably than not that as this situation evolves, that if there is a formal ruling that applies across the board, that the direction the IRS is going to say, look, these are not going to have any tax consequence on the claimant. Really what we're talking about is the tax cuts among the players involved in all of these transactions. That's my understanding how this issue is really --

MR. LOWMAN: I would agree. I think that the private letter ruling that's been issued indicates that the service doesn't want to drop the hammer, so to speak, on the injured party.

REPRESENTATIVE GANNON: One last question. Is there anything that prevents --

I'm an casualty insurance company. I'm part of the Gannon Mutual Insurance Companies. We have a life company, a fire company, an accident and health company; we have a casualty company. Is there anything to say, look, I get to a claimant and I say, we'll give $1.4 million over 30 years. That's going to cost me five hundred.

I go across the hall to my life company. They sell annuities. I take the $500,000 and walk across the hall to my life company and say, I want to buy 1.4 million over the next 30 years, and I'm going to pay $500,000 as premium. Is there anything to prevent me from doing that under existing laws?

MR. LOWMAN: No. No. This goes to the question that was asked earlier about who are structured settlement brokers. Structured settlement brokers are out there and they work both sides of the transaction.

What will generally happen is, the plaintiff's attorney will hire a so-called broker or structured settlement advisor, and the casualty company will hire a structured settlement advisor. In the terms of negotiating the settlement, they will say, well, I think this case is worth a million dollars. What can we structure -- What kind of annuity can we get for a million dollars?

Then they take that and they submit that to the life insurance company and the life insurance company will say, well, for a million dollars you can buy an annuity that's going to pay $25,000 a year for the remaining life of the claimant, whatever the number is. That's the way these deals are generally done.

Back to your question earlier about, are people fully informed? They're represented by counsel. They have the opportunity to go out and hire someone, plaintiff's counsel does, to hire someone that can tell them, what is its worth; what is its cost; and what is its value. Is it done in all cases? No. But, it's done increasingly more.

REPRESENTATIVE GANNON: I was involved in a structured settlement prior to -- when I worked in the insurance industry prior to the '82 tax code. That was not the big issue back then. The big issue was attorney fees on the settlement. I would imagine that's still an issue today that sometimes leads to these things failing because the attorney fees can't be worked out on the structured settlement.

That was the major issue at that time. Taxes were not -- I'm sure it was coincidence, but that wasn't a factor that says, saving something on the policy limits or keeping our retention or whatever. Attorney fees were a big issue with the Plaintiff's Bar with respect to those settlements. Thank you.

CHAIRPERSON CLARK: I'd like to thank you, gentlemen, for your testimony --

REPRESENTATIVE MICOZZIE: Wait.

CHAIRPERSON CLARK: Representative Micozzie.

REPRESENTATIVE MICOZZIE: As you probably know, I've been interested in the CAT Fund privatizing. You said something about the CAT Fund. I take it they are structured settlements?

MR. LOWMAN: My understanding is that they are structuring about forty to $50 million a year in their claims.

REPRESENTATIVE MICOZZIE: And the reason why they're not lump sum, is the factoring because of the disclosure of --

MR. LOWMAN: Well, no. I think that the total CAT Fund claims in a year are somewhere under a hundred million dollars. Approximately 45 to 50 percent of those they put into structured settlements. They're making evaluations I assume as to the $50 million that might be settled in lump sums and then forty to $50 million in claims that are going to be structured.

They're making some evaluation about, well, this person is injured. Looks like a lifetime disability. We ought to provide lifetime payments to that individual. That's the same kind of evaluation that takes place with respect to any structured settlement.

REPRESENTATIVE MICOZZIE: Does the factoring companies go after those people?

MR. LOWMAN: All I can tell you is that there's a court case that's been filed in Pennsylvania under the Freedom of Information Act to get the list of CAT Fund claimants that have structured settlements.

MR. MARSHALL: The administration opposes giving out that list to those factoring companies. When the administration is in charge of the structured settlements giving out the money to the CAT Fund, they don't want those recipients to be solicited by factoring companies.

REPRESENTATIVE MICOZZIE: When they send it to a firm, annuity firm, whatever, they're under that restriction?

MR. DYER: Absolutely, yes.

REPRESENTATIVE MICOZZIE: Thank you, Mr. Chairman.

CHAIRPERSON CLARK: I want to thank you, gentlemen, for your testimony today. For the committee's information, our own Pennsylvania Swift Fund is buying lump sum, or making lump sum payments to people to buy their workers' comp claim with very little or no disclosure. The last time I saw was (drops voice). Thank you, gentlemen.

The next individual to testify in front of the committee is Robin Shapiro, Esquire. Thank you for standing by.

MR. SHAPIRO: Actually, we have here five individuals, three of whom are on the witness list, who have been waiting all morning to come in. I'm going to ask the committee's indulgence to secede much of my time now so these folks can get on and tell stories to you and get out of here at a decent time.

CHAIRPERSON CLARK: Why don't you go ahead and bring them up and introduce them to us.

MR. SHAPIRO: My name is Robin Shapiro. I'm a lawyer. I'm counsel for Singer Asset Finance Company. I grew up in Upper Darby, went on to law school out of state. I've done a number of things in the practice of law.

I'm spending quite a bit of my time over the past six months talking to state legislatures around the United States about this same issue, and much of this same bill as it has been presented in up to, I think 24 state legislatures around the United States.

I should say that the bill in the form that it's presented to you now, many of the issues that you're looking at today have been examined and rejected by the vast majority of state legislatures which have looked at this.

Example, the standard. The standard, which we are told has to absolutely be in the state statute in order to jive with the anticipated federal standard, has been rejected by the vast majority of state legislatures which have considered it. The sky is not falling.

The private letter ruling which was directed to a special settlement claimant; a private letter ruling sought by my company, my firm, which I'm quite familiar, in no way conditioned the finding that there be no adverse tax consequences on a finding of eminent financial hardship. That standard is not to be found in the private letter ruling.

Obviously, you've heard now close to two and a half hours of testimony and a range of issues. I am prepared to address what I find to be really a great deal of misrepresentations and misinformation about this issue at length in the form of either a presentation or questions.

These folks have been sitting here and I've been barely able to contain them from screaming up in anger as they've been listening to a characterization of what structured settlements are about or what structured settlement factoring is about. They actually have had structured settlements. They've actually dealt with the insurance industry, both in the creation of a structured settlement in the first instance in their effort to try to get some of their cash out when their life circumstances changed, and in factoring transactions tell you, each of them, their own stories.

What I would ask you to do, and I only had a chance, frankly, to meet these folks that have done business with various different companies from around the United States. They're all from this area, from as far away as Lancaster, Darby, Center City Philadelphia. One I think is South Jersey, but dealing with a Philadelphia-based company.

I would ask each of them to try to confine their remarks to about five minutes, say who you are, basically what your story is, what you feel about your understanding as to what the legislature is considering here.

Some of these folks are under the restrictions of confidentiality being imposed upon them by insurance companies. While they can tell their story, they're not going to be able to tell you the name of the insurance company involved.

With that, I think maybe we should start --

CHAIRPERSON CLARK: Why don't you folks introduce yourselves and explain why you've decided to come down here today to tell your story.

MS. SPATH: My name is Teresa Spath. This is my husband Douglas. This is our daughter Sarah.

We began to attempt to sell our settlement, my settlement precisely, in November or October of '97. After battling with the insurance company it finally came through this February. We amassed a list of lawyers' bills upwards of $5,000, which came directly out of my pocket. The settlement companies helped us to a point, but there came a point where they couldn't help us anymore. If it hadn't finally gone through, I don't know what we would have done.

I'll tell you what. We've heard a lot about victims today. We've heard a lot about how the people who have these settlements are being victimized. I don't know why the insurance companies are so interested in that because, quite frankly, this insurance company that are here telling these stories are the same people that didn't want us to get any money in the first place. Why are they all of a sudden so interested in us?

They have also talked about how there's a danger to the factoring companies that are making these settlements as far as taxes go. Again, why are they so interested? When I was a little kid I was told to mind my P's and Q's and so was my brothers and sisters. Why don't the insurance companies mind their P's and Q's and leave us out of it.

We went through so much misery. We nearly -- We did lose a car. We had it repossessed because we were not able to get this. Before we got involved in this, we crunched our own numbers. We did not call anybody at first. We sat down and said, is this going to be a good thing for us to do.

After discovering how much it would cost us to not pay off our credit cards immediately, to continue to pay rent and not get a house where we could know that we can live for a very long time, to what if we had a child, which at the time I didn't know that she was going to be on the way soon, what would happen if I had to quit work because I didn't make enough money for it to be beneficial for me to put her in day care, which I don't believe in anyway. So we needed to find a way out of this, a way to protect ourselves. This is what we did.

It ended up costing us more money and misery than I can even imagine. The only reason I had a settlement in the first place is because my parents fought tooth and nail to even find a lawyer who would take the case 20 years ago. We almost didn't get anything out of these people for a man who very possibly may have caused me never to be able to be insured by a health insurance company.

Now, luckily, I don't think I'm going to have too many problems. I may have some in the future when I hit 40 or so, but for now, I'm 20 years old and I'm in good shape. But no thanks to either of these people who are trying to put a stop to this process. Beyond that, I can also say that I'll answer questions if you have them. There's too much to tell to fit it into five minutes.

CHAIRPERSON CLARK: Thank you. There very well may be some questions. We'll move on. Tell us your name.

MS. CLIETT: My name is Desiree Cliett. I went to Peachtree Settlement. Obviously, when I listen to a lot of the comments and things being made, what I don't understand is, if the money is there and the money is yours, why can't you have access to it? On one hand the insurance company I dealt with, they had their hand out in one notion and they had their foot on top of me with another. It was like they were there to help, but then they weren't there to help.

It was a thing where, it's like, I wanted to get access to money to further my life and make things better for me and my children. It was at a point in time where my brother unfortunately passed away. It will be two years this Christmas. It's like at that point in time it was like a wake-up call for me. It's like all this money is there. There's things that I want to do for myself and my children.

It was telling me that years down

the road there might not be no time for me to do things because things happen unexpectedly. So I went to Peachtree Settlement and I got -- the finances enabled me to start my own business, to do things for my family and my children to make things better in my life.

But my point is, I don't see why they -- In the stories I hear you tell about people who got money and they're broke and they're on financial assistance, or whatever, to get the money and have finances you have to use this to further do something with it. I don't know what these people did or didn't do, but I know that I don't feel like I'm robbed.

My life is much better from this. I'm more comfortable. My children are more content. It's not a stress-free life, but I don't think it's fair what they are doing. And how can they put some stipulations on someone else's money and what they want to do it with it? I just don't think that's fair at all.

I'm very happy with what I've done. I'm glad I made that decision and I have no regrets.

As far as things I have heard I

cannot agree. I was kind of very angry about a lot of statements that were made because -- I just want to say that I think -- I'm trying to put this correctly without saying the wrong thing, being very negative. I just think this is not a bad thing. I don't think that they should put any stipulations on this. I don't think these companies should be given a bad name, bottom line in my opinion.

CHAIRPERSON CLARK: Thank you.

MR. BROADDUS: My name is Michael Broaddus. I live in the City of Darby, P.A. As far as me, I'd like to give you all an earful of what's going on as far as my situation. My situation arrived with a settlement as far as me injuring my back. I have two slipped disks in my back. I still further worked because I have to continue to work to take care of my family. I lost my job. Then I have to pay child support. In order for me not to go to jail because they were going to send me to jail for child support, I went to Singer Asset.

As far as the contract that I signed with them and the payments that has been purchased from them, it suits me fine. Any loss as far as the amount that I didn't get, I feel as though it wasn't a correct amount to maintain or do anything, I did what I wanted to. The decision that I make -- And I feel that the insurance company, they should not have the right to tell me what to do with my money.

The contract that we had as far as understanding this is what you're going to do. You have to do this. You can't sell your payments and then all of a sudden you find out that you're able to sell your payments. Then the company as far as buying the payments, if you say, like listening to some of the comments, You cannot do this and you can do this are -- you can go get advice from somebody else, but then again, it may not be the right thing for you. You have to make your decision from that.

I say as far as the money that I received that I've done well. I'm fine and I'm content. That's about as much as I'd like to say to keep it brief.

CHAIRPERSON CLARK: Sir.

MR. TYBURCZY: My name is Jonathan Tyburczy. I currently reside in Lake Hiawatha, Jersey. My story is a little bit different.

I'm really glad I'm sitting here because back in '85 I was involved in a car accident. I went into a ditch where there was no signs around. So I went down about six feet, kicked the car door open. What I wound up doing was suing the landscaper that owned the property. I can't mention the insurance company. But eventually I got a structured settlement. In '87 I was a six-figure income. I worked in the carpet business. I worked as a manufacturer's rep.

What happened in my case was very unique. I was probably one of the top five salesmen in the company. My company was bought and sold. My boss got fired and the guy that became my boss was my competitor on the street. So, that didn't last for long at all. I was forced to resign after 12 years with the company. That's when the real horror story began.

About six years ago I tried to go into the insurance company and tell them I wanted to cash in my settlement because I was in the process of losing my home. I really had virtually no income coming in. The money I was making now was probably about a quarter of what

I was making before. I had a car repossessed in '93. My father died suddenly in '93, and I lost my house to foreclosure in '93.

I could say, nobody would wave the flag more than me for J.G. Wentworth. When they came into my life, they funded me earlier on the full settlement; got a chance to clear some of my bills; had a chance to get my license back from the State of New Jersey because I had a fine that I had to pay. And as a salesman, if you can't drive, how are you going to make a living? They also helped my pay some utility bills because I was getting to the point where my service was going to be shut off. That was in the old house.

I am currently renting now in Lake Hiawatha. Me and my wife have been to hell and back for 11 years. If it wasn't for J.G. Wentworth -- I currently settled with them as far as getting my money, and it totally changed my life around. Thank God for companies like that.

CHAIRPERSON CLARK: Let me just ask one question. In all of those situations you signed a paper where the check went to the company, Singer or whomever, and then they sent you a check less what you agreed that they would keep of that check?

MS. SPATH: Actually, we had to loophole around our insurance company. We would be in court to this day if it weren't for the fact that they had bigger problems than us and they wanted to make us disappear. We agreed to have the payment sent to our lawyer. Now he's going to send them back down to the company after he receives them.

CHAIRPERSON CLARK: And the insurance company agreed to this arrangement?

MS. SPATH: They agreed to -- We structured it as a loan. They have put a confidentiality clause on me. They made it look like there was no assignment because it is going to my lawyer. But there was an assignment, because like I said, they had other things they wanted to deal with and we went away.

CHAIRPERSON CLARK: So as far as you know they've maintained their tax benefits, et cetera? That wasn't part of the discussion?

MS. SPATH: In fact, the letter that they sent us explaining why they would not do this, there was only one almost valid reason out of the ten that they listed. That was the tax issue. When I discussed that with my lawyer and with several other people they said, it's not an issue. Don't worry about it. When it finally came down to it, especially when they discovered that I did not have a clause in my contract that said I could not assign it, they went oops, and decided to let me out.

REPRESENTATIVE GANNON: Can I ask a question. With respect to this assignment issue, is that something that's required as part of this transaction to keep it tax free, or is this something that the insurance companies are putting in there and the structured settlement companies are putting in there for their own benefit? Do you understand what I'm saying?

MR. SHAPIRO: Yes, I do. I think the vast majority of the agreements are set up as structured in the first instance have some form of an anti-assignment or anti-pledge agreement. I can't speculate as to why they do it. They will say they do it to preserve the tax structure, but they don't do it in every case, and yet, they do take the same tax position even in those cases where that is not present. We haven't seen a pattern as to why it's in and why it's not in. It's a form that companies use.

One thing I want to ask the panelist because, as they spoke they didn't say -- because I heard committee members ask, how many of you when you settled your case were given the option of a lump sum; in other words, the choice between a lump sum or take it over time versus a sort of a take it or leave it? This is the deal you will be paid. Was anybody given a choice?

MR. BROADDUS: Yes, I had a choice.

MS. CLIETT: At the time I was a minor. This case was settled when I was 14 and I graduated from junior high. The case was, my mother went in for a simple tubal ligation. The hospital made a bad one. She died at the age of 28. She's younger than I am today. I'm 30.

They did not want to give -- I remember being in the court. They didn't want to give me and my brother anything. They fought with them and they said, how do you know her mother would have been financially stable? The point is, they don't know what she would have been, but she was taken away from me at the age of 10 and my brother was 2.

MR. SHAPIRO: In your case it wasn't a compensation or injury to you.

MR. CLIETT: No.

MR. SPAPIRO: It was, rather, you were basically inheriting -- you were getting an award for somebody else's death which you couldn't get in a lump sum because you were a kid at the time of the award.

MS. SPATH: Mine was similar in the fact that the case was settled in '83 and I'm 22 now, so I would have been approximately seven or Eight years old.

MR. SHAPIRO: Was it an award for somebody else's injury?

MS. SPATH: It was an award for medical negligence is what it was referred to at the time. I had a congenital birth defect that was not discovered until I was 19 months old, at which point it advanced to the point that they didn't know what to do with me. When they finally did what's called shelf building that created a hip socket for me, which I was lucky because otherwise, I wouldn't be able to walk.

At the time that they discovered it, it should have been discovered a long time ago because the head of my femur was approximately here (indicating), in my ribs. I was walking barely and my mother kept taking me back to the same doctor and saying, what is the matter with my daughter? And he said she's fine. She'll grow out of it. That's why he had to pay up.

CHAIRPERSON CLARK: And both of you got your full amount after you became an adult so it didn't need to go back through the courts?

MS. CLIETT: When I turned 18 they started sending me payments. It was supposed to be in the amount of a thousand dollars a month. They were being taxed, so all I was getting was eight ninety-six a month. This was suppose to be a tax free thing. That's what I couldn't understand. So I had to go through a thing of signing lots of documents just to get it from being taxed. That took awhile, a good while.

MR. BROADDUS: I had a choice as far as my injury on the job. I had a choice as far as a settlement, as far as taking this portion or having that. The insurance company kept saying it would double. I had the different payments. Mine right there was a choice. I made that choice.

MR. SHAPIRO: Did you have a lawyer?

MR. BROADDUS: Yes, I did.

MR. TYBURCZY: My lump sum was tied up for 13 years, and approximately six years later I tried to cash it in; went to the insurance company. The best analogy I can give in this is, it's like standing outside a bakery and they've got my cake inside, and I can't eat it. That's probably the best way I can explain it.

These companies like J.G. Wentworth and Singer, I'm glad they're around to help people like us. Now that we have been funded, at least some of us, I'm sure it's changed our lives. It's what we had to go through to get what we had to get.

REPRESENTATIVE GANNON: The company you dealt with, the factoring company, did they just write you a check and sign documents? Did they give you any financial counseling or financial advice or assistance or anything like that? You said they helped you with your electric bill. I was just wondering how --

MR. TYBURCZY: No. That was J.G. Wentworth. The insurance company I can't mention, but the insurance company had the thing tied up for all these years.

REPRESENTATIVE GANNON: I meant the factoring company. J.G. Wentworth --

MR. SHAPIRO: Wentworth is what he's calling the factoring company.

REPRESENTATIVE GANNON: Did they help you -- In other words, did they give you any counseling or assistance?

MR. TYBURCZY: Yes.

REPRESENTATIVE GANNON: So they didn't just write you a check and say thank you --

MR. TYBURCZY: No, no.

RREPRESENTATIVE GANNON: -- sign these papers, here's the money. See you.

MR. TYBURCZY: They explained. They were upfront with me, and that's what I liked about them. At the time of need they helped me, and that's the bottom line, really.

REPRESENTATIVE GANNON: They did more than that.

MR. TYBURCZY: Changed my life

around.

MR. SHAPIRO: I think these folks should be available to answer the committee's questions, but then, obviously, there were a lot of points that were raised that are detailed points on the bill, on the tax issues, lawsuits you have heard about that I want to address quickly because, obviously, we're very far along in the day. I have to respond to about two and a half hours of testimony in probably 10 minutes.

CHAIRPERSON CLARK: Representative Hennessey.

REPRESENTATIVE HENNESSEY: Thank you, Mr. Chairman. Mr. Tyburczy, do you have any idea what kind of discounted rate was applied to your settlement? Did you pay a 30 percent premium or take 30 percent less in order to get your settlement?

MR. TYBURCZY: No.

REPRESENTATIVE HENNESSEY: At least some statistics have been given to us that suggested -- You settled with a lump sum, correct?

MR. TYBURCZY: Yes.

REPRESENTATIVE HENNESSEY: They were discounting you 35 or 40 percent, or 28 percent.

MR. TYBURCZY: As a matter of fact, that's a very good point. They gave me the full value of my settlement less the early funding that I had as far as paying off some of my bills. The rate was 12 percent.

REPRESENTATIVE HENNESSEY: Mr. Broaddus, do you know what kind of a discount you got?

MR. BROADDUS: It was 17.4 percent. It was a loan. As far as buying the payments, when the P.O. box, as far as giving the P.O. box, the insurance company didn't want to go through that. They had to give me a loan for the restructured payments that I had.

REPRESENTATIVE HENNESSEY: You think it cost you about 17 percent in order to get --

MR. BROADDUS: Yes.

REPRESENTATIVE HENNESSEY: Desiree?

MS. CLIETT: Mine was 17.5 percent.

REPRESENTATIVE HENNESSEY: Ms. Spath?

MS. SPATH: It was 16.5 percent face value, but as I noted earlier, it would have cost me more to wait to pay off my 18 percent credit cards.

REPRESENTATIVE HENNESSEY: Which is 22 or 23 percent.

MS. SPATH: Right.

REPRESENTATIVE HENNESSEY: Okay. Thank you. That's all I have. Thank you.

CHAIRPERSON CLARK: Mr. Shapiro.

MR. SHAPIRO: We have a lot of ground to cover. I don't want to burden the committee. It's the Chair's pleasure. If you tell me how much time you have to allocate, I will try to confine my remarks.

CHAIRPERSON CLARK: Eighteen minutes. The last gentleman to testify, we're going to take his testimony and put it in the record. We apologize for any inconvenience we caused him today, but we learned an awful lot this morning.

MR. SHAPIRO: Mr. Chairman, then if I could ask the committee, since I'll try to confine my remarks to being less prepared remarks and try to address open questions which have been floating around, if I can leave you some written testimony for distribution to the committee members after the close of the open hearing, maybe we can cover a lot more issues that way.

There's a lot of discussion of lawsuits against consumers, a lot of statistics about J.G. Wentworth having hundreds of cases with a terrible disability. I just wanted to make sure that everyone here understands what that's all about.

The companies that are providing cash to people in exchange for payment over time are essentially a kind of consumer finance company. They do many tens of thousands of transactions around United States. They're extending credit to people who otherwise have the traditional forms of consumer credit at their disposal.

These are people who, in fact, if they went to a bank to get a loan at any rate, would likely to be a very high rate, credit card rates of 22 and 25 percent. And the rates are as high as they are because as a risk they're not getting paid back. After all, what we're talking about here is a company putting money out upfront, hoping to get paid back according to a schedule of payments over time.

Every one of the cases of which there are hundreds out of the many tens of thousands of transactions from the United States, represent an instance where a consumer regrettably took the money from the factoring company and then kept the payments too. Just so you understand that.

In other words, of course, there are lawsuits when a consumer takes $10,000 or $20,000 from a finance company and promises to direct some portion of some identified payment in the future. But then, instead, calls up their insurance and says, send them back to me, there's going to be a lawsuit. That's what those lawsuits are about.

There's nothing particularly surprising or strange about the fact that out of tens of thousands of transactions in the consumer finance business you're going to have a two to three percent diversion or default range.

One case I wanted to speak about specifically was the Alison Grieve case in Vermont, which involved my company, where a court was presented with a transaction where this person obviously was relying upon, based upon our own intake form, the payments which she was proposing to sell.

The question was, why was she in court? She was in court, and why do we have that form? Because we will not buy payments as an ordinary matter of course from an individual who is depending upon those payments for their means of support.

We told her, we are not going to buy those payments from you unless we present the facts of your situation to a court and the court decides what to do. We told the court all the facts, including the fact that she was depending on these payments, she had an immediate need for them. Yet, of course, she would also lose income over the long term if she sold them, and laid out all of the tough factors and the obvious choice she faced as to whether she should not do the things she had to do upfront to continue to get three or $400 a month, or instead sell $200 a month.

We said, we won't do that transaction without a court looking at it. The court in that case said, I don't think she should do this. Fine. That's how it should work. That's what you would expect the company to do. We didn't just go forward and take those payments that she was depending upon from her. We didn't do that transaction. We went to a court and said we won't do this transaction unless you say we can. In that case the court said we couldn't. That's sort of how you would hope the system would work.

To make it clear, again, without going through all of the details of the argument ranging from tax issues to disclosures, a couple things. We support legislation like this. There are versions of this kind of legislation that are pending in New Jersey right now, that have passed in Georgia, that are pending in California, around the country that we could actively support.

This version is not regulation. It's a bad masquerading as regulation. If you tell folks who are trying to raise $10,000 or $20,000, but they're going to have to incur five to $6,000 worth of transaction costs to gain access to $20,000, that's a show stopper.

The lottery model, which I work with

Pennsylvania legislation, creates the lottery prize winners doesn't work. Why doesn't it work? Because when companies like us buy lottery prices, we're giving the lottery winner $700,000, $800,000.00. If you tell a lottery winner that they have to have a lawyer, go to court and have a waiting period and go through a number of steps that cost three or $4,000 to do this, that's not a show stopper for a $700,000 financing, but it is a show stopper for a $15,000 financing?

What I would as this committee to consider is an approach that makes the regulation in the secondary market tiered and proportionate, which is to say, if you're talking about relatively small transactions, the size of financings that would be the kind of things when someone was trying to buy a car, bring bills current, pay off child support, do the kinds of things you heard these people wanted to do with some of their payments; that there be all kinds of disclosures we're familiar with in consumer lending, discount rate disclosures, interest rates, cancellation periods, admonition to consult with counsel, all of those things.

And then, if you get to a certain size transaction, you actually have to have a lawyer or a financial advisor. If you get to a certain level, you say, you know what, I think now this is getting to be a big enough transaction, we're going to ask you to have a court look at this.

But, if you tell people who are trying to raise $7,000 or $12,000, they have to have the kinds of procedures that are unheard for any other kind of transaction known to law frankly, except probate, or settlement of a minor's claim, you're going to put layers of transaction costs on that will either force people out and around the system into a true gray market; make it impossible for institutional players to bring money in, or just make it -- Or you're going to get the perverse result where companies are going to say, our threshold to do a transaction, giving away a transaction cost, is $20,000. I know you only need twelve and should hold back a portion of your payments, but if you want to do the deal we're going to have to ask you to actually borrow more than you need to just so you can meet the hurdle that's imposed by the regulatory framework that it's so expensive.

I would hope to be able to provide this law to you with some proposed amendments that provide that kind of idea what a tiered proportion regulatory framework would be.

One other thing because there was a lot of discussion about what we call front-end disclosure. Let there be no mistake about it. Right now there's no requirement in the law that people who are settling cases to be given a choice between lump or payment over time. There's no requirement in the law that that choice, if it's given, be expressed as a rate of return on an investment or an interest rate.

The fact is, for better or for worse, it's extremely valuable to insurance companies to tell people who are coming in and selling cases, I got you your hundred thousand dollar settlement. Sign here, $4,000 a year for 25 years, and call that a hundred thousand dollars; knowing full well it's not costing them a hundred thousand dollars, but only a small fraction; maybe twenty-seven, $40,000 depending on the prevailing interest rates at the time you settle that case. There's no obligation at all to express a promise of payment over time as present value, like the lottery does when they give you the cash option versus the payment over time.

And, I think what is worse is, the way these cases get settled now is, in a settlement conference often what happens is that an individual will come in and present herself or himself as kind of a free financial advisor. Someone comes in with defense counsel or the insurance company says, let's set down and we're going to plan that meets your life needs and maybe some money here; maybe a little money farther out.

They're sitting with a laptop computer, and every time they can throw a payment off into the future, the bottom line for the insurer is dropping. That bottom line is never shown to the plaintiff in that discussion.

But then what happens is, that person doesn't tell the claimant -- He's not really a free financial advisor. He's a broker who is only going to get paid if he successfully persuades plaintiff's counsel or plaintiff to structure settlement. He's going to get four percent off the top if he sells everybody on the idea of structuring. There's no requirement in place today in Pennsylvania that requires that to be disclosed. At the very least, the person who is going to be advised by someone, that person who is giving the advice whether he be required to say, hey, I only get paid if you take a certain kind of advice; in this case the advice of structuring over time.

The fact is, structured settlements, structuring cases, is extremely lucrative today for insurance companies. Think about it for a moment. Here's how it works. Person comes in has a number in his head. I want a hundred thousand dollars.

Property and casualty insurer they may have reserved thirty-five thousand or $40,000 for that claim. Property and casualty insurer can go either through a broker to another annuity provider or to a sister company in the same corporate family and say, we'll take the forty thousand we preserved to buy an annuity that's going to pay out $4,000 a year for 25 years. You can tell the plaintiff they're getting their hundred thousand dollars.

In the meantime, the corporate family is holding -- had never paid out anything more than $4,000 a year. They're holding that entire 34,000, or whatever it is, that was reserved, and then gets it invested in Yahoo stock and earn all of that rate of return, tax free, courtesy of the federal government, and then pay out at Christmas club rates over the course of 25 years to the claimant.

This is a fabulous deal and one well worth protecting and mounting a major effort around the country by the insurance industry. Unfortunately, these commercials that we use to advertise our services to consumers are having the effect of educated people about present value. When I have a commercial on television using Judge Wachner or some other grass-spokes person and one of my competitors have someone else saying, the gist of the commercial being, are you a person who's getting paid out over time? Call this 800 number and we'll tell you what you're really getting.

We are raining on their parade

because we are telling consumers generally, including the next person who is considering entering a structured settlement, that maybe $4,000 over 25 years really isn't a hundred thousand dollars.

Now, I don't want to rain on their parade too much because, frankly, my business is corollary and ancillary to the presence of structured settlements. I want there to be structured settlements, and I want to serve as a safety valve, essentially, for those people whose circumstances change, because they make sense, certainly for the person who has been catastrophically injured depending upon the payments.

I don't want you to be selling them (drops voice; inaudible words) payments and (drops voice) paying the electric bill -- It's no longer about that. It's about that certain fraction of the cases, but such a lucrative thing for insurance companies to be able to settle cases this way, slips and falls, dog bites, and every manner of thing is being settled through a structure, and now you have a community of people around the United States who are getting $200 a month, $100 a month or three hundred. This is not enough to maintain life. It's kind of additional stipend.

They want to buy a house. They want to get a car. They want to pay off their child support payments. They want to get restarted because they lost their jobs. There's lots of legitimate reasons why people want to do these things.

Do they constitute imminent financial hardship? I don't know. I don't want to litigate what that means in order to do a funding of $18,000.00. So what I would ask you each to do as you're considering this issue -- I understand the process. This was a meeting to hear information from citizens, from industry representatives, and from people in the business, to consider what you've heard, to consider what we'll be providing to you in the way of written information ranging from detailed opinions on the tax issues, to examples of other legislatures have addressed this issue and suggested language you may want to consider in addressing this issue.

Understand that -- I think the

challenge here is a balance. The balance needs to be, make sure that you have enough information being provided to consumers so that people can make meaningful choices and make meaningful comparisons among providers and not getting into bad deals and have information they need to make choices, both when they're choosing in the front end and take cash upfront or payment over time, or later if they are choosing to exchange payments over time for cash.

Make certain that you don't so burden the process with protections and with procedures that it becomes too expensive for people to do what they often need to do. This is a big problem for thousands of people in Pennsylvania. I think you need to think carefully about exactly how you do it because the devil are in the details. I'm going to reserve most of my comment on details for the written material.

I thank you all for the time and attention you've taken to listen to us today. I'm here to answer your questions.

CHAIRPERSON CLARK: We have a quick question from Representative Gannon.

REPRESENTATIVE GANNON: So I'm clear, you were reciting this situation up in New England about this woman. Did that transaction, did that have return?

MR. SHAPIRO: No, because we didn't get court approval.

REPRESENTATIVE GANNON: I got the question that you were suing her because she had said --

MR. SHAPIRO: You were given that impression. I'm trying to clarify.

REPRESENTATIVE GANNON: Why is it any different? Was there ever any suit against her to try to --

MR. SHAPIRO: No. She was bringing suit in court as a petitioner to seek approval to do a transaction; had laid out, with our assistance, all the facts of her situation where there was no good answer. We told her, we are not going to buy unless you get court approval. The court did not give approval.

CHAIRPERSON CLARK: Representative Micozzie.

REPRESENTATIVE MICOZZIE: Has your industry and the insurance industry tried to sit down and reach some kind of compromise?

MR. SHAPIRO: We have a history of trying to do that. I'm hopeful, frankly, that as this process evolved and cost a lot of time and money, that there may be some opportunity for doing that.

I think probably -- Suffice to say, there may be some opportunities for that kind of dialogue between each of the parties.

REPRESENTATIVE MICOZZIE: You haven't --

MR. SHAPIRO: This weekend, Mr. Dyer and I had a conversation at the NCOIL meeting, which the National Conference of Insurance Legislators, in Ohio about scheduling just such a meeting within the next two weeks.

REPRESENTATIVE MICOZZIE: Thank you.

CHAIRPERSON CLARK: Counsel Preski.

MR. PRESKI: We were told you purchased a workmen's comp settlement and that's illegal. Do you buy workmen's comp settlements?

MR. SHAPIRO: Never have; never will. If you want to say it's illegal, again, it's illegal and we really mean it, I can support that, because we don't do it.

Bottom line is, we buy these things, put money upfront, and we hope to get paid in the future. How can I pull these things up and get moodys (phonetic) to rate them and sell them in bond if I'm buying stuff I'm not allowed to buy? I don't do it.

REPRESENTATIVE MICOZZIE: Go to jail too.

MR. SHAPIRO: And I'd go to jail too. They don't pay me enough to do that.

REPRESENTATIVE HENNESSEY: Mr. Chairman, when we invite Mr. Shapiro to submit written testimony and perhaps some other testifiers, could we ask that you address and the other people address the real distinction and give us concrete examples of how the standard best interest of the claimant would differ from financial hardship so the committee has a real clear -- exactly what's invested in each of those.

MR. SHAPIRO: I'll prepare something that speaks directly to that.

CHAIRPERSON CLARK: My understanding is that, we have developed a way to get around the hardship standard that's in the Internal

Revenue Service Code.

MR. SHAPIRO: There's no standard in the code at all. The private letter ruling said it was okay without having to show hardship.

CHAIRPERSON CLARK: But these people all structured theirs with a loan or something so that --

MR. SHAPIRO: There's that, but Representative Hennessey had a very good idea. His idea echoed something that's already in the Pennsylvania code in the lottery section. The lottery statute says, there's some uncertainty about tax (drops voice) --

THE COURT REPORTER: Excuse me. I can't hear you.

MR. SHAPIRO: There is some uncertainty, very limited, in the tax law about the selling of lottery prize payments. Instead of saying you can't do it until sometime in the indefinite future when all uncertainty is resolved, the way the lottery statute works is, you can do it. Here's how you can do it. If there should ever adverse ruling, then you have to stop.

In other words, instead of making

resolution a condition precedent it's poison, adverse resolution is a poison pill. That's how you do it right now in your statute (drops voice) --

CHAIRPERSON CLARK: Thank you. We want to thank you very much and the individuals for coming in and telling us their experience. It's real life. Meeting adjourned.

(At or about 12:20 p.m. the public hearing adjourned).

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C E R T I F I C A T E

I, Karen J. Meister, Reporter, Notary Public, duly commissioned and qualified in and for the County of York, Commonwealth of Pennsylvania, hereby certify that the foregoing is a true and accurate transcript of my stenotype notes taken by me and subsequently reduced to computer printout under my supervision, and that this copy is a correct record of the same.

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Karen J. Meister

Karen J. Meister - Reporter
Notary Public

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