

Annuities and Managed Money

Paul J. Lesti, CSSC
Lesti Structured Settlements, Inc.
888.537.8477
www.lesi.com
paul@lesi.com

Annuities and Managed Money

“Dimme Futuro... lo fatte ricchi”.

Translation...”If you tell me the future...I will make you rich”.

Introduction

- “If you accurately predict the future... I will make you rich”

Protect Attorney and Plaintiff

Attorney biggest fear: Might get sued

- Client may live too long and run out of money
- Investment may lose money
- Investment may not meet legal compliance

Plaintiff's biggest fears (above 1st two)

- May not meet their needs

Client outlives money

- Grillo case
- Profoundly injured infant
- High rated age (not expected to live long)
- Case settled upon early death assumption and commensurate funds into trust
- Structured Settlement not considered
- Child lives longer. GAL settled \$2.5 mil.
- Attorney for \$1.4 mil.

Client outlives money

- Solution
- Transfer this mortality risk to those who are in the business of taking it.
- Life insurance companies are built and regulated to take on this risk

Investment May Lose Money

- Need to keep the plaintiff's money safe
- “Rate of return on the investment of the moneys must be deemed secondary to preserving the principal sum...”
 - Hilgarth v. Costello 132 Misc. 2d. 1020
- Prudent man rule, preserve capital
 - If demand growth and capital preservation one potential solution: equity indexed annuities

Legal Due Diligence

- May need guardian not just GAL when managing property, i.e. making investment decisions for a minor.
- Make sure there is proper judicial approval
- Consider statute's approved investment list
- Trustee or owner succession
 - Learn from Stanwich and SBU failures

Legal Due Diligence

- Public policy
 - Fiduciary responsibility of trustee
 - Can trustee absolve itself from liability?
- Arbitration provision
 - May preclude court's jurisdiction
- Trust accounting must properly follow statute
- May consider having independent investment advisor

Legal Due Diligence

- Consider the revocation process of the trust

In the Matter of the Estate of Yolette MEDE, deceased. 177 Misc.2d 974, 677 N.Y.S.2d 707, 1998 N.Y. Slip Op. 98467.

Plaintiff's Needs

- Daily lifetime living expenses (if you are alive you need money)
- \$40,000 per year for average family
- Build in inflation –
“long-term inflation expectations appear to have been contained.” Fed Chair Bernanke, Feb. 16, 2006.

Plaintiff's Needs

- Realize it is a zero-sum game
- May not have enough funds after fees & expenses due to inherent nature of legal system
- Due to such a shortfall be careful not to overcompensate by taking risks with investments
- May settle for too little with high theoretical projected rates of return

Plaintiff's Needs

- Asset allocation (depends on clients needs and risk tolerance)
- Cash upfront
- Triple emergency fund protection guidelines
- One liquid – (3 – 6 months of expenses depending on needs)
- One growth oriented
- One income producing

Plaintiff's Needs

- Match needs with proper financial vehicle
- “Only an annuity can pay an income that can be guaranteed to last as long as you live” (National Association of Insurance Commissioners)
- Take appropriate risk for injury victims
 - Can they return to work?

Plaintiff's level of risk tolerance

- Profoundly injured child
- Inexperienced investor
- Lack of knowledge
- Another source of income?
- Require lifetime income?

FINANCIAL NEEDS	POTENTIAL APPROPRIATE INVESTMENTS OPTIONS
Lifetime tax-free income	Structured settlement annuity
Lifetime taxable income	Fixed immediate or deferred annuity
Growth, no capital risk with a guaranteed rate of return.	Equity indexed annuity, capital safe Variable annuity, capital safe
Growth with capital at risk	Managed account
Emergency cash fund	Short term investments CD's, money market, bond fund.

Investments

- Attorney has legal duty to advise client on non-legal issues, e.g. financial. Model Rules of Professional Responsibility. Rule 2.1
- Structured settlement is statutorily based. IRC 5891.

Due Diligence Investigation

- What is the product?
- Who regulates the marketer and the product provider?
- Insurance commissioner, SEC, NASD?
- Are there outside rating agencies?
- Is there outside investment oversight?
- Industry standard ratios?
- Track Record
- Transparency of all fees and expenses
- Suitability of investment to plaintiff

Due Diligence Investigation

- Needs of the plaintiff, needs wants and experience
- That will dictate the appropriate investment product choice, not the other way around
- May choose more than one to meet plaintiff's needs
 - E.g. An investment with capital risk for some inexperienced investors is similar to a dive master taking a first time diver down 100 feet
- Like a hedge fund, private placement trusts may avoid scrutiny of traditional regulators.

Investment Products- Fees

- “M&T [Manufacturers and Traders Trust Co.] cannot both charge the investment advisor fee and also receive compensation from the Vision mutual funds. It must elect which fees to take and which to forego.”

In the Matter of Derek W. Bryant an Infant.
188 Misc.2d 462, 729 N.Y.S.2d 309.

Investment Products- Fees

- What are the costs and are they ongoing?:
 - Commissions
 - Administrative
 - Advisory
 - Trust
 - Mutual Fund
 - Broker dealer fees

Investment Products

- How many annuity, trust administrators, or investment companies are compared?
- Assess the risk that the financial provider and or owner of the asset may enter bankruptcy or liquidation
- Assess the risk of the continuity of the administrator
- Is there third party oversight?

Interest Rates

- If you don't have a guaranteed rate of return, how do you assess the risk of what future interest rates will be.
- Crystal ball gazing, or
- Risk assessment tools:
 - Monte Carlo Simulation
 - Future simulation of large number of potential outcomes using past performance
 - Used in mathematics, physics and economics, etc
 - Past actual rates and not random numbers used

Interest Rate Risk Assessment

- 40 year old male – no transfer of mort. risk.
- \$1 mill. less 4% expenses to generate \$62,818/yr. for life, growing 3%, with the first 10 years certain, starting in one year, to duplicate a Structured Settlement (rated age 60).
- Add \$2,400 in expenses.

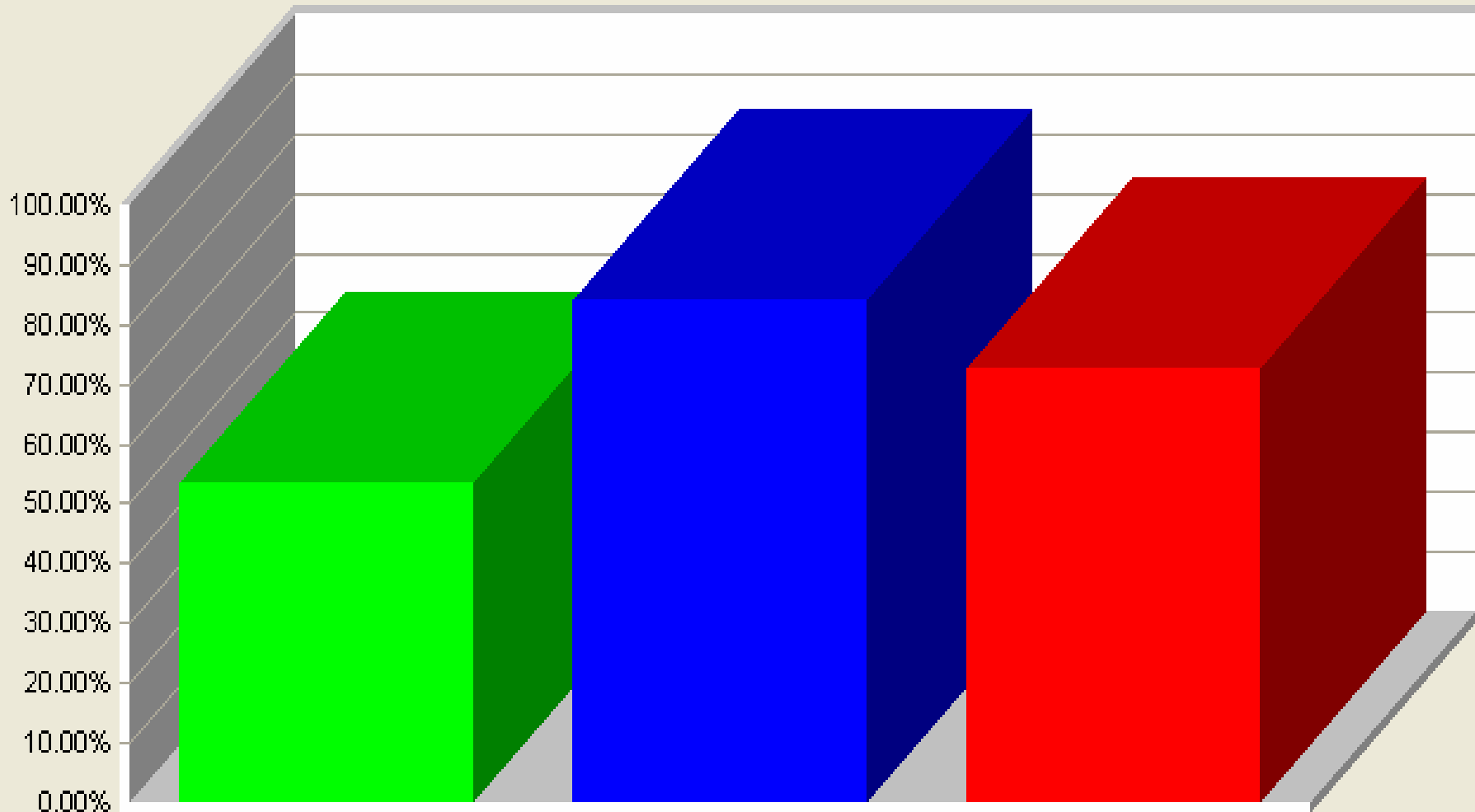
Probability of Dying with Money

Monte Carlo Simulation

(time frame: Jan. 1985 to present)

- S&P 500 / Munis: 30/70% **53.5%**
- S&P 500: 100% **84.1%**
- S&P 500 / Munis: 50/50% **72.5%**

Chance of Success

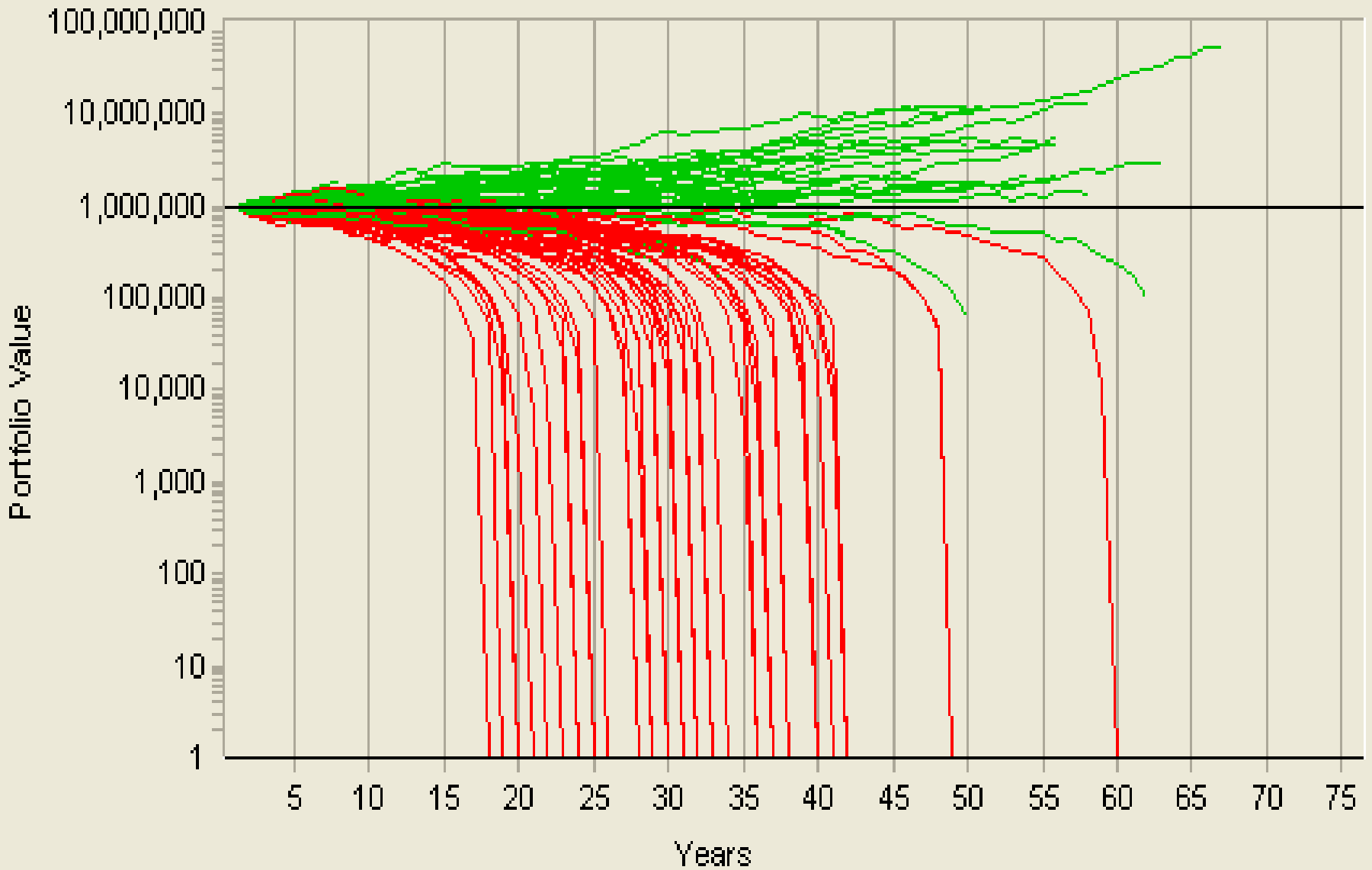


S&P 500 / 70% Muni Bonds 1/85 (53.5%)

S&P 500 100% 1/85 (84.1%)

50% S&P 500 / 50% Muni Bonds 1/85 (72.5%)

Trials for Investment: A

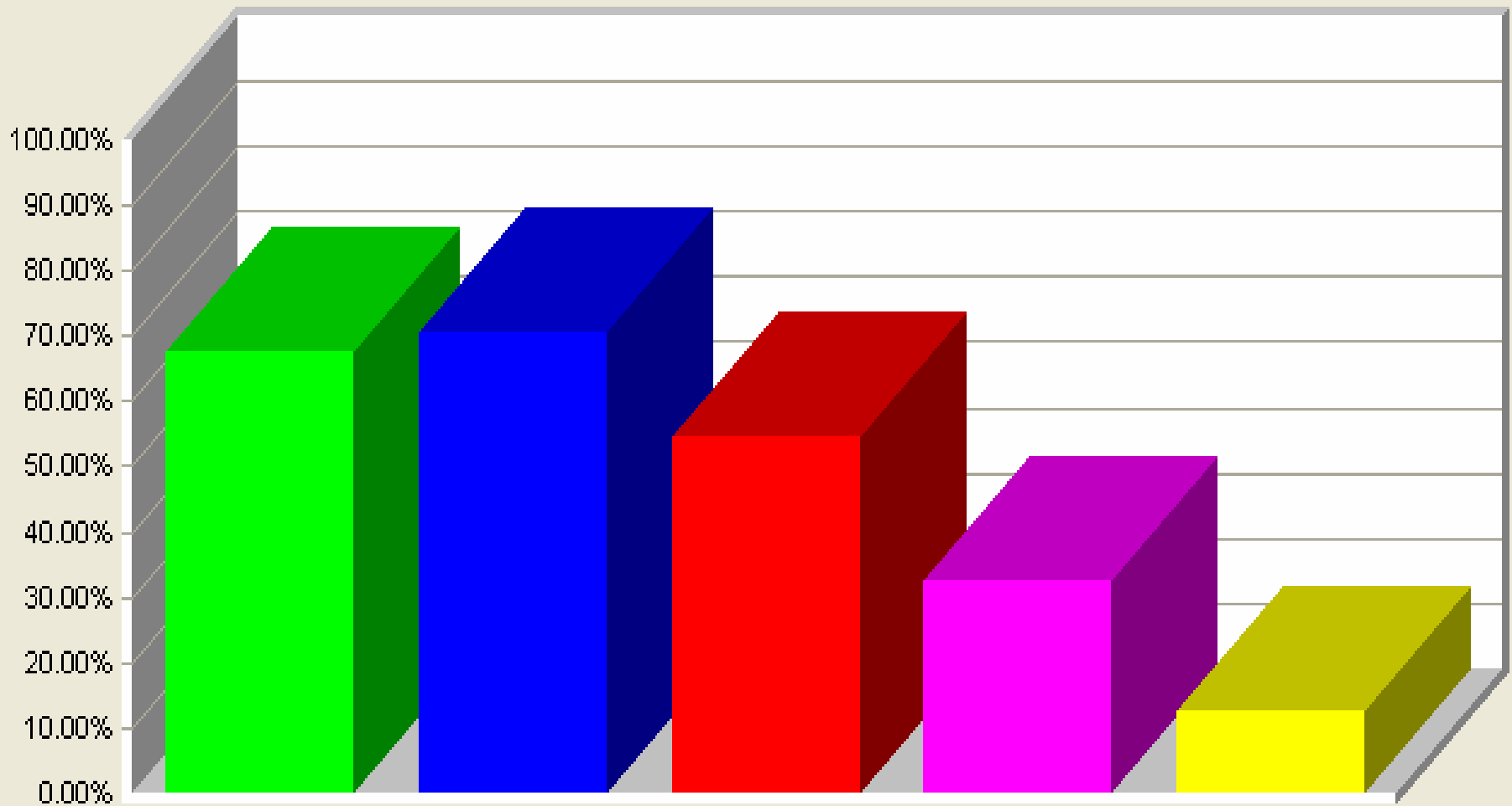


Probability of dying with Money

(1933 S&P and 1943 for bonds to present)

- S&P 500 100% **67.5%**
- S&P 500 / 10 yr Treas. 80/20% **70.5%**
- S&P 500 / 10 yr Treas. 60/40% **54.7%**
- S&P 500 / 10 yr Treas. 40/60% **32.3%**
- S&P 500 / 10 yr Treas. 20/80% **12.6%**

Chance of Success



S&P 500 1933 (67.5%)

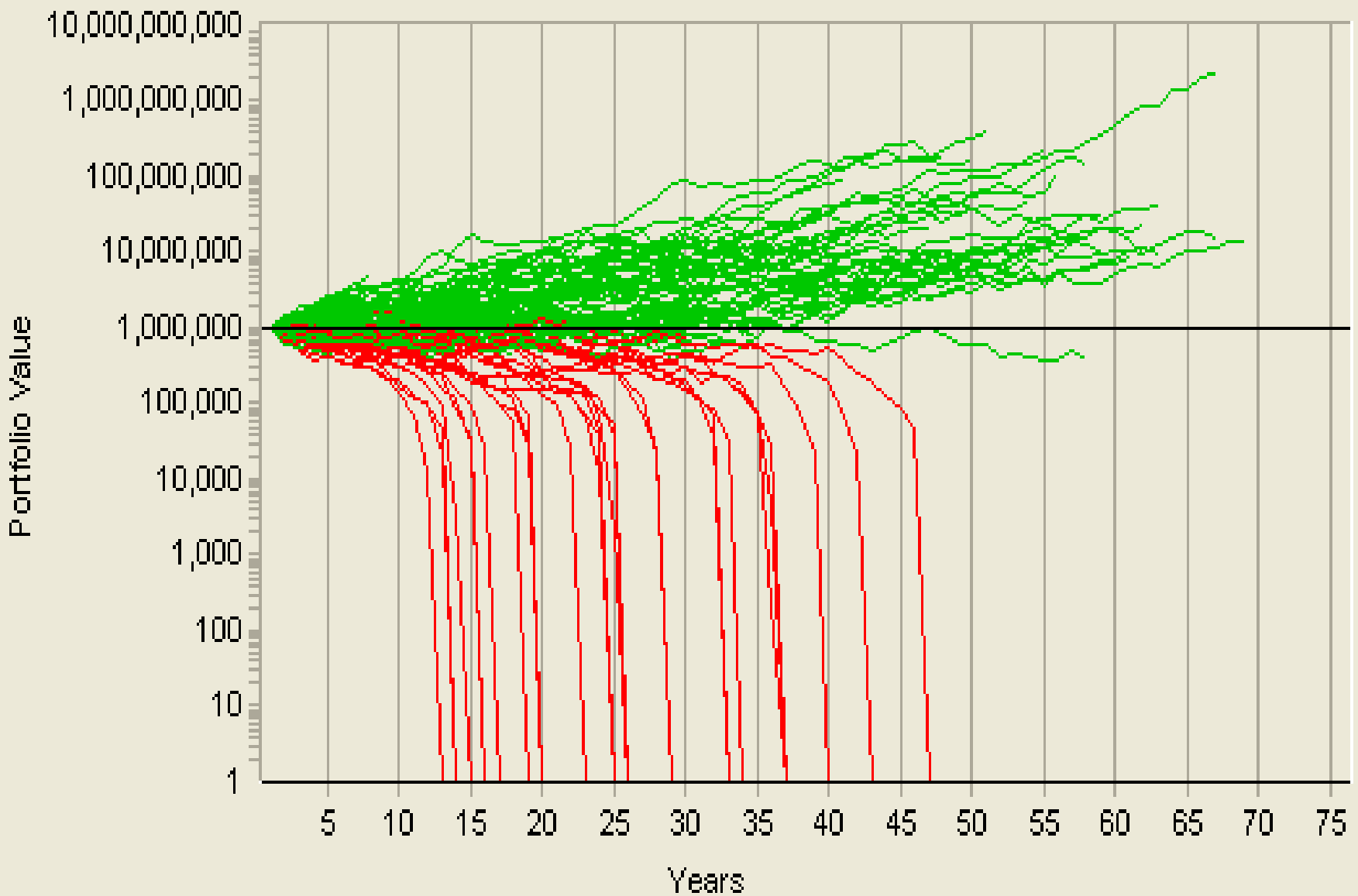
S&P 500 1933/10yr Treas. 1943 60/40 (54.7%)

S&P 500 1933/10yr. Treas. 20/80 (12.6%)

S&P 500 1933/10 yr Treas. 1943 80/2 (70.5%)

S&P 500 1933/10yr Treas. 1943 40/60 (32.3%)

Trials for Investment: A



Interest Rate Assessment

- If lose 20% in one year
- Start with \$1,000,000, \$800,000 remains
- What rate of return is needed to get back to \$1 mill.?

Interest Rate Assessment

- Need 25% rate of return to get from \$800,000 to \$1,000,000

Mortality

- 2 year old, \$3,500 mo life and 10 years certain, growing 3%.
- Cost \$1,700,000
- Rated age of 60
- Cost is now \$813,000

Withdrawals affect future payment streams

- Early withdrawals from managed money account reduces future payment projections and the assumption of available funds.
- Solution: Separate growth fund from income fund
- Like separating your term life insurance from your own growth oriented personal investments

Investment Fees

- Managed Money
 - Taken out at time investment is made
 - 10AM had \$1,000,000.00, at end of the day had \$960,000.
- Annuities
 - Commission included in the price and reflected in proposed rate of return. Of course it comes out of the premium. The commission is amortized over the life of the payment stream

Taxes

- Must consider tax rate of a trust versus a structured settlement and other annuities.
- Equity indexed annuities for example are tax-deferred income
- Structured Settlement is tax-free
- Managed money may invest in tax-free municipal bonds, which have a lower rate of return than taxable ones.

Due Diligence Questions

- Are future payments tax-free?
- Are future payments guaranteed?
- Are future payments payable for life?
- What are underlying assets?
- What is assumed growth rate?
- Impact of taking out money on illustrated stream?
- Costs and fees

Plaintiff's Structured Settlement Advisor

- Recent memo
- Spoke with the author today.
- As long as the plaintiff's attorney discloses commission relationship to the plaintiff, then commission relationship acceptable.
- He is willing to learn about Structured Settlement industry.

Conclusion

- Perform legal and financial due diligence (use checklists as a roadmap)
- Transfer mortality and other risks to appropriate entities.
- Assess needs and risk tolerance of injury victim
- Use appropriate financial products to meet specific needs.
- One financial product cannot do everything for everyone.
- Take a multidisciplinary approach.

Lesti Structured Settlements, Inc.

www.lesi.com
paul@lesi.com

888.537.8477