

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

House Bill 535

(The Speaker, *et al.*) (By Request - Office of the Attorney General)

Judiciary

Judicial Proceedings

Courts and Judicial Proceedings - Structured Settlements - Transfers and
Registration of Structured Settlement Transferees

This bill makes several changes to the procedures for filing and approving an application for a transfer of structured settlement payment rights, including establishing a registration program for transferees under the Office of the Attorney General (OAG). The bill also authorizes the Attorney General to adopt regulations to carry out the purposes of Maryland's Structured Settlement Protection Act (Title 5, Subtitle 11 of the Courts and Judicial Proceedings Article).

Fiscal Summary

State Effect: Minimal increase in general fund revenues from registration fees and civil penalties collected by OAG beginning in FY 2017, offset by a minimal increase in general fund expenditures for OAG to administer the registration program, as discussed below. While the number of applications are unknown, for each application OAG receives, registration fee revenues increase by \$2,000, \$1,500 of which must be refunded if the application is denied.

Local Effect: The bill's requirements can be met with existing local resources.

Small Business Effect: None, as discussed below.

Analysis

Bill Summary: Under the bill, the General Assembly finds and declares that regulation of transfers of structured settlement payment rights is necessary to (1) ensure that the transfers are effectuated on fair and reasonable terms and are in the best interests of payees and (2) protect payees against deceptive practices.

Definitions: The bill alters and establishes several definitions, including the definitions of “independent professional advice” and “structured settlement payment rights.”

The bill redefines “independent professional advice” in these transfers to mean the advice of an attorney, certified public accountant, actuary, or other licensed professional adviser who is engaged by a payee to render advice concerning whether a proposed transfer of structured settlement payment rights would be in the best interest of the payee, taking into account the welfare and support of the payee’s decisions. The bill retains the other existing components of this definition.

The bill redefines “structured settlement payment rights” as the rights to receive periodic payments, including lump-sum payments under a structured settlement, whether from the settlement obligor or the annuity issuer, if (1) the payee resides in this State; (2) the structured settlement agreement was approved by a court or responsible administrative authority in this State, and the payee does not reside in another state or jurisdiction that has enacted a statute providing for entry of a qualified order as defined under 26 U.S.C. § 58911(b)(2); or (3) the settled claim was pending before a court of this State when the parties entered into the structured settlement agreement and the payee does not reside in another state or jurisdiction that has enacted a statute providing for entry of a qualified order as defined under 26 U.S.C. § 58911(b)(2).

Authorizations of Transfers and Findings: The bill prohibits the direct or indirect transfer of structured settlement rights, unless the transfer is authorized in a court order based on express findings that:

- the transfer is necessary, reasonable, and appropriate and in the best interest of the payee, taking into account the welfare and support of the payee’s dependents;
- the financial terms of the transfer agreement are fair to all parties, taking into account the difference between the amount payable to the payee and the discounted present value of the payments to be transferred and the discount rate applicable to the transfer;
- the payee received independent professional advice concerning the proposed transfer; and

- at least 10 days before the date on which the payee signed the transfer agreement, the transferee provided to the payee a separate disclosure statement that includes specified information, including (1) the amounts and due dates of the structured settlement payments to be transferred; (2) the aggregate amount of the payments to be transferred; (3) the discounted present value of the payments to be transferred; (4) the amount payable to the payee in exchange for the payments to be transferred; (5) specified information about various fees, costs, and charges; (6) the net amount payable to the payee after deduction of specified costs, expenses, and charges; (7) the discount rate applicable to the transfer; (8) the amount of any penalty or liquidated damages payable by the payee in the event of any breach of the transfer agreement by the payee; and (9) a statement that the payee has the right to cancel the transfer agreement, without penalty or further obligation, at any time before the transfer is authorized by a court.

Venue: A petition for a transfer of structured settlement payment rights must be filed in the circuit court for the county where the payee resides (if the payee resides in the State). If the payee does not reside in the State, the petition must be filed in the circuit court that approved the structured settlement agreement or the circuit court in which the settled claim was pending when the parties entered into the structured settlement agreement, if the structured settlement agreement was not court-approved.

Proposed Transfers Involving Cognitive Injuries: If, in any proposed transfer of structured settlement payment rights, the structured settlement was established in resolution of a tort claim seeking compensation for cognitive injuries, including any claim arising from childhood exposure to lead paint, the transferee must notify the court in its petition that the payee may be cognitively impaired; attach to the petition a copy of any complaint that was pending when the structured settlement was established; and identify any allegations or statements in the complaint that describe the nature, extent, or consequences of the payee's cognitive injuries.

When determining whether to authorize these structured settlement payment rights transfers, the court must consider whether to appoint a guardian *ad litem* for the payee or to require the payee to be examined by an independent mental health specialist designated by the court. The transferee must be responsible for the payment of any fees of these guardians *ad litem* or independent mental health specialists.

Registration of Transferees: The bill prohibits a person from filing a petition for a transfer of structured settlement payment rights unless the person is registered with the Attorney General as a structured settlement transferee or has a pending application for registration, and the Attorney General has not acted on the application within specified timelines.

An applicant for registration as a structured settlement transferee must submit an application containing specified information to the Attorney General under oath and pay a \$2,000 registration fee, of which \$1,500 is refundable if the Attorney General denies the application. All registration fees collected must be used to administer the registration program.

The Attorney General must grant or deny an application within 90 days of submission of the complete application and all applicable fees if the applicant is not registered with the Attorney General as a transferee at the time the applicant submitted the application. The Attorney General may require transferees to reapply for registration on an annual basis or less frequently. The Attorney General must grant or deny a renewal application within 30 days of submission of the complete application and all applicable fees. The Attorney General may extend the deadline for granting or denying an application by 60 days if the Attorney General determines that additional information from an applicant is needed. If the Attorney General denies an application, the Attorney General must specify in writing the reason for the denial.

Accepted Applications: If the Attorney General accepts a transferee's application for registration as a structured settlement transferee, the transferee must promptly (1) file with the Attorney General an irrevocable letter of credit in the amount of \$100,000 issued by a financial institution; (2) deposit \$100,000 in cash with the Attorney General; or (3) file with the Attorney General a bond that is in favor of the State, in the penal sum of \$100,000, and executed by a surety insurer. The bill contains procedural/administrative provisions pertaining to these bonds, including liability of the surety insurer and cancellation of the bond. If the transferee fails to comply with these provisions, the Attorney General may deny, suspend, or revoke the registration of the transferee until the transferee complies.

Suspension or Revocation of Registration: The Attorney General may suspend or revoke the registration of a structured settlement transferee or deny an application for registration if the Attorney General finds that the transferee or other specified individuals (1) engaged in specified prohibited practices/activities; (2) have been convicted of a crime involving dishonesty, deception, or moral turpitude; (3) have been found by a court of competent jurisdiction or a government agency to have committed fraud, engaged in unfair trade practices, or committed any other civil wrong or regulatory violation involving dishonesty or deception; or (4) otherwise failed to comply with the bill's provisions.

Penalties: In addition to, or instead of, denying an application for registration, or suspending or revoking registration, the Attorney General may impose a civil penalty for each violation of specified provisions. The maximum penalties are \$1,000 for a first violation and \$5,000 for each subsequent violation. The Attorney General must consider specified factors when determining what type of action to take or the amount of any civil penalty to be imposed. The bill also specifies notice and hearing requirements.

Any party aggrieved by a decision and order of the Attorney General under specified provisions may petition for judicial review.

Statements by Obligor: If a structured settlement obligor imposes fees and charges totaling more than \$350 in connection with a transfer, the obligor must submit a statement to the payee and the transferee identifying specified information regarding persons who performed work on the transfer, the time spent on the work, and reasonable hourly fees for the work.

Current Law/Background: Under a traditional settlement agreement, the claimant in a personal injury or workers' compensation action receives a single, lump sum payment in settlement of his or her claim. Under a structured settlement agreement, the claimant (or "payee") instead agrees to receive multiple, smaller payments – typically paid out over the course of many years. Structured settlements have several benefits from a public policy perspective. First, they promote the long-term financial stability of the payee by providing a steady stream of income that can be used to pay future expenses arising from the payee's injury or disability. Second, they minimize the risk that the payee will squander his or her award and become reliant on public assistance. In support of these objectives, federal law encourages the use of structured settlement agreements by granting special treatment to structured settlement payments under the tax code.

Factoring Transactions: Since 1975, insurance companies have committed an estimated \$350 billion to structured settlements. This has given rise to a secondary market for structured settlement payments. In some cases, a payee may choose to transfer the rights to receive future payments under a structured settlement agreement in exchange for an immediate, discounted, cash payment. This is called a "factoring transaction," and the companies that specialize in these transfers are known as "factoring companies." Proponents of the factoring industry argue that factoring companies provide an important service to individuals who typically do not have access to traditional forms of credit. A payee may use the cash acquired through a factoring transaction to purchase a vehicle, make a down payment on a house, pay emergency medical bills, or cover other large expenses. However, critics argue that factoring transactions undermine the protective purpose of structured settlement agreements.

In August 2015, *The Washington Post* published an exposé of Maryland's factoring industry. The story described payees, many of them victims of childhood lead poisoning, who had sold their rights to structured settlement payments for pennies on the dollar. One company featured in the article petitioned to buy about \$6.9 million worth of future payments – which had a present value of \$5.3 million – for about \$1.7 million. The article raised questions about how Maryland regulates the factoring market and the extent to which current law adequately protects vulnerable payees from aggressive or misleading business practices.

Maryland's Structured Settlement Protection Act: According to the National Association of Settlement Purchasers, as of November 2015, 49 states, including Maryland, have adopted some sort of structured settlement protection act. Although the statutes vary in their details, all of them require judicial oversight and approval of factoring transactions.

Maryland's structured settlement protection law, codified in §§ 5-1101 through 5-1105 of the Courts Article, was enacted in 2000. The law prohibits the direct or indirect transfer of structured settlement rights, unless the transfer is authorized in an order of a court based on a finding that:

- the transfer is necessary, reasonable, or appropriate;
- the transfer is not expected to subject the payee or the payee's dependents to undue or unreasonable financial hardship in the future;
- the payee received independent professional advice regarding the legal, tax, and financial implications of the transfer; and
- the transferee (typically, a factoring company) disclosed to the payee the discounted present value of the future payments being transferred.

The transferee must file with the circuit court and serve on all interested parties a notice of the proposed transfer and an application for its authorization.

One of the primary criticisms of Maryland's structured settlement protection law is that it is vulnerable to inconsistent application. While the law requires a court to determine whether a transfer is "necessary, reasonable, or appropriate," it provides no clear guidance on how the court should reach that determination. As a result, judges are left to apply their own, necessarily subjective, criteria to each factoring transaction. Another issue is presented by the law's jurisdictional provisions, which allow petitions to transfer structured settlements to be brought in any county with jurisdiction over an "interested party." Critics have alleged that the law allows factoring companies to "forum shop" for a judge more amenable to their position. Several publications have reported that petitions are overwhelmingly brought outside of payees' counties of residence. There is concern that when a court does not have ties to a payee, it may be less sensitive to the payee's needs and more likely to approve a transaction that is not in the payee's best interests.

Critics also question whether State law adequately assures that payees receive independent professional advice concerning factoring transactions. The law defines "independent professional advice" as the advice of an attorney, certified public accountant, actuary, or "other licensed professional adviser," who is engaged by the payee to render advice concerning the legal, tax, and financial implications of a transfer of structured settlement payment rights. This broad definition of adviser poses several problems. If the adviser is

not an attorney, he or she should not be providing legal advice to the payee. On the other hand, if the adviser is an attorney, he or she may not be competent to give advice regarding the tax or financial implications of a transfer agreement. Moreover, although the law specifies that the adviser may not be affiliated with the transferee, many factoring companies provide payees with lists of potential advisers, and some companies even offer to advance the advisers' fees. Payees and their advisers are not required to attend or testify at hearings to approve the transfer of structured settlement rights. Therefore, it is often difficult for courts to assess the qualifications of a particular adviser or to determine how well a payee understands the terms of a particular transfer agreement.

Changes to the Maryland Rules: In response to articles in the *Washington Post* and the *Maryland Bar Journal*, on October 15, 2015, the Standing Committee on Rules of Practice and Procedure submitted a report to the Maryland Court of Appeals recommending certain changes to the Maryland Rules. The Court of Appeals ordered that the new rules be adopted on December 7, 2015. The rules went into effect on January 1, 2016, and apply to all actions commenced on or after that date and, insofar as practicable, all actions pending on that date.

The rules are intended to provide structure and guidance with respect to proceedings on petitions to approve the transfer of payment rights under a structured settlement agreement. Key provisions of the rules include:

- a petition for court approval of a structured settlement transfer must be filed in the circuit court for the county where the payee resides (if the payee resides in the State), the circuit court for the county in which the most recent petition was filed (if the payee does not reside in the State but a petition has been filed in the State for the payee in the past), or any circuit court (if the payee does not reside in the State and does not have any prior filed petitions);
- the payee (unless excused by the court), the payee's independent professional adviser, and a duly authorized officer or employee of the transferee must be present to answer questions at the hearing on the petition;
- the court may appoint a guardian *ad litem* for the payee or arrange for an independent mental health evaluation of the payee; and
- the payee must consent to the transfer by completing a specified consent form.

“Qualified Order” under 28 U.S.C. § 5891: 26 U.S.C. § 5891 pertains to the imposition of taxes on acquired structured settlement payment rights. 26 U.S.C. § 5891(b)(2) defines a “qualified order” as a final order, judgment, or decree which (1) finds that the transfer of structured settlement payment rights in a structured settlement factoring transaction does not contravene and federal or state statute or the order of any court or responsible administrative authority and is in the best interest of the payee, taking into account the

welfare and support of the payee's dependents and (2) is issued under the authority of an applicable state statute by an applicable state court or by the responsible administrative authority (if any) which has exclusive jurisdiction over the underlying action or proceeding which was resolved by means of the structured settlement.

State Revenues: General fund revenues increase minimally beginning in fiscal 2017 from registration fees collected by OAG under the registration program established by the bill. Future year general fund revenues increase depending on the registration renewal cycle established and the amount of civil penalties imposed by OAG. (The bill authorizes the Attorney General to require a structured settlement transferee to reapply for registration on an annual basis or less frequently, as the Attorney General determines.)

Data is not readily available on the number of applicants/registrants anticipated under the bill. For each application for registration it receives, general fund revenues increase by \$2,000; of this amount, \$1,500 must be refunded if the application is denied.

General fund revenues could also increase to the extent any transferees deposit cash with the Attorney General; however, it is assumed that most transferees deposit a bond or file a letter of credit with the Attorney General instead.

State Expenditures: General fund expenditures increase minimally for OAG to administer the registration program. The bill requires OAG to use the registration fees it collects to administer the program.

This analysis assumes that the bill's provisions regarding administrative hearings and judicial review of final decisions on disciplinary actions do not materially affect State finances.

Small Business Effect: The bill alters the findings a court must make before approving a transfer of structured settlement payment rights and the definition of "independent professional advice." This analysis assumes that structured settlement purchasers are not small businesses and that the bill's provisions do not materially affect small business independent professional advisers. This analysis also assumes that factoring companies and surety insurers who provide bonds to registrants are not considered small businesses.

Additional Comments: While the cross-filed bills SB 734 and HB 535 of 2016 are intended to be identical, HB 535 contains a reference to a nonexistent federal statute (*i.e.*, 26 U.S.C. § 58911) and SB 734 refers to the existing federal statute (26 U.S.C. § 5891). Accordingly, these cross-filed bills are designated as nonidentical.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, SB 734 (The President, *et al.*) (By Request - Office of the Attorney General - Judicial Proceedings) is not identical.

Information Source(s): Baltimore City, Office of the Attorney General, Judiciary (Administrative Office of the Courts), Maryland Department of the Environment, National Association of Settlement Purchasers, Department of Legislative Services

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