

Big Windfalls and Structured Settlements – What They Are, and How to Handle Them

If you've received this windfall, it might sound like you're fixed for life. The reality is that your financial life has changed drastically, and you need to plan for it.

A structured settlement is a way of receiving partial payments for a major amount of money you've won or received in a lottery, a court or insurance case. You hear a lot of commercials on the air for getting cash from structured settlements, but it's important to understand what they are and how they should be handled if you're ever the recipient.

A good place to start is with a tax expert like a certified public accountant, a financial planning expert like a CERTIFIED FINANCIAL PLANNER™ professional, or an attorney or structured settlement consultant who has significant experience dealing with these payment structures. When there is big money at stake, it might make sense to consult all three. Some ideas:

First, the definition: A structured settlement is structured like an annuity. It is a contract written by an insurance company that provides periodic payments to a winner in a lottery, a lawsuit or some other settlement arrangement over time. Amounts can be paid out weekly, monthly or yearly.

The benefits: Structured correctly – and with the right oversight going in – a structured settlement annuity provides a payment stream that may be tax-free over a period of time during the winner's lifetime and remaining payments may be bequeathed to his or her survivors after their death.

The pitfalls: One should never accept a structured settlement agreement without vetting it against their own tax situation or estate needs. Also, it helps to have an expert who understands these agreements well enough to know whether certain fees or charges connected with that settlement are appropriate to the overall size of the award. Keep it in mind that the structured settlement must be purchased by the person or company that is at fault or is making the award. This is why it's particularly important to have an expert watching over that selection process from the moment the award is announced.

The lump sum alternative: If a winner chooses a lump sum payment over a periodic payment based on the full amount of the award, that payment will likely be handled with an insurance contract that physically pays the lump sum but at a much heftier chunk of the full total – they get a big payoff for giving you a big one-time payoff. Keep in mind that the lump-sum payoff idea may not be worth pursuing unless it's large enough to throw off substantial investment income in the future and that you have talented management making sure that lump sum makes money over time. This is why it's always a good reason to confer with tax, financial and investment experts on the best way to go with either a lump sum or a periodic payment from the moment you've been informed you won the money.

Keep in mind that others get an advantage too: Many attorneys are also structuring their fees that are taken directly out of a court award. This allows them to postpone receiving their share of an award on a tax-deferred basis so they can build their own retirement funds. There's nothing wrong with this, but it's important to know who else in the process might benefit from any decisions that get made.

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February 2009 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Crossbridge Financial Group LLC, a local member of FPA. Crossbridge is located at 2000 Winton Road South, Building 5 Suite 102, Rochester, NY 14618. Phone (585) 292-0430. Securities and advisory services offered through Commonwealth Financial Network member FINRA/SIPC, a Registered Investment Adviser.