



SEC

OFFICE of INVESTOR
EDUCATION and ADVOCACY

INVESTOR BULLETIN

Pension or Settlement Income Streams

What You Need to Know Before Buying or Selling Them

Do you receive a monthly pension from a former employer? Are you getting regular distributions from a settlement following a personal injury lawsuit? If so, you may be targeted by salespeople offering you a lump sum today to buy the rights to some or all of the payments you would otherwise receive in the future. Retired government employees and retired members of the military are among those being approached with such offers. Typically the lump sum offered will be less—sometimes much less—than the total of the periodic payments you would otherwise receive.

After acquiring the rights to a future income stream (such as a retiree's pension payments), these pension purchasing or structured settlement companies, sometimes called "factoring companies," may turn around and sell these income streams to retail investors, often through a financial advisor, broker or insurance agent. These products go by various names—pension loans, pension income programs, mirrored pensions, factored structured settlements or secondary-market annuities. They may be pitched to investors with words like "guaranteed" and "safe"—and may tout robust returns that outpace more traditionally conservative investments such as CDs or money market accounts. The advertised returns may sound enticing, but investors should be aware that these investments can be risky and complex.

FINRA and the SEC's Office of Investor Education and Advocacy are issuing this Investor Alert to inform anyone considering selling their rights to an income stream—or investing in someone else's income stream—of the risks involved and to urge investors to proceed with caution.

What Is a Structured Settlement?

A typical structured settlement involves the resolution of a personal injury or workers compensation lawsuit, which often takes the form of "structured" or periodic payments made to the injured party. The periodic payments are commonly funded by an annuity issued by an insurance company, and are often structured to provide a dependable stream of income and a degree of financial security to the injured party.

Selling Your Pension or Structured Settlement Income Stream

In a typical transaction, the recipient of a pension or structured settlement will sign over the rights to some or all of his or her monthly payments to a factoring company in return for a lump-sum amount. And the lump-sum amount that factoring companies offer will almost always be significantly lower than the present

value of that future income stream. (Simply put, present value is the amount of current money needed to obtain the future stream of payments and is based on a periodic rate of return, such as an interest rate).

Most states require factoring companies that purchase structured settlements to disclose this difference. In California, for example, the disclosure must identify the dollar amount of the payments being sold, the present value of those payments based on a federally established interest rate, the amount being paid to the seller, and the interest rate calculated as if the transfer were a loan and not a sale of the payment rights.

Factors to Consider When Selling Your Income Stream

In uncertain financial times, you may find yourself searching for immediate cash to help pay for rising or unanticipated expenses. For example, even though your pension provides steady income, you may not feel it's enough to make ends meet. At first glance, selling your future pension benefits might seem attractive, especially if mortgage, medical or other expenses loom. Under certain circumstances, these transactions may have their benefits.

However, there are several factors to consider before selling away the rights to your pension or structured settlement income. Transaction costs—including brokerage commissions, legal and notary fees, and administrative charges—can be high. You will need to think about how to replace the cash flow your pension or structured settlement income provides, especially if you depend on that income stream to pay monthly or other expenses. Furthermore, be aware that some salespeople can be aggressive or persuasive when trying to get you to sell your income stream and, in some cases, there may be outright fraud.

Before selling away an income stream you currently receive, ask the following questions:

- **Is the transaction legal?** Federal law may restrict or prohibit retirees from “assigning” their pension to someone else.¹ Furthermore, the secondary sale of a structured settlement often must be approved by a court, in keeping with the Uniform Periodic Payment of Judgments Act (UPPJA). Before selling your pension or structured settlement, you may wish to ask your pension administrator what restrictions may apply, review the terms of your settlement or consult an attorney.
- **Is the transaction worth the cost?** Find the discount rate that the factoring company has applied to your income stream to arrive at the lump-sum amount. This is in essence the interest rate that is used to bring the future dollars you will receive from your pension into today's present value. The larger the discount rate applied to your pension payments, the lower its value in today's dollars. So, if the factoring company is using a high discount rate, you can expect to receive a lower lump sum. Compare this rate to alternatives such as a bank loan or other options that may be less costly. You should also take into account commissions, fees, and other administrative costs.
- **What is the reputation of the company offering the lump sum?** Check the factoring company's record with the [Better Business Bureau](#), and research the firm on the Internet and with a financial professional. What complaints have been filed against the company? Were complaints resolved to the customers' satisfaction?

¹ The assignability of pension benefits is addressed in the United States Code, including provisions governing military benefits within 38 USC §5301, civil service benefits within 5 USC §8346(a) and private pension benefits within 29 USC §1056(d).

■ **Will the factoring company require life insurance?**

When you sell your pension, or even a portion of your pension payments, the factoring company may require you to purchase a life insurance policy. They may require you to name the factoring company, or the investor buying the income stream from them, as the beneficiary of the policy. Should you die before all payments you assigned to the factoring company have been received, funds will be paid out from the life insurance policy to cover any remaining balance. Keep in mind that purchasing a life insurance policy will add to your transaction expenses and reduce your payout.

■ **What are the tax consequences?** The lump-sum payment you collect may be taxable. Discuss the tax implications of any transaction you are considering with a tax professional.

■ **Does the sale fit your longer-term financial goals?** While you may feel you need money now, take time to evaluate your financial objectives down the road. It can be helpful to work with a financial professional who will not receive compensation from, or will not otherwise be involved in, the transaction. You may find that there are other alternatives to deal with your immediate needs. Don't necessarily take the first offer that comes your way.

Investing in Pension or Structured Settlement Income-Stream Products

Recent stock market volatility and a low interest-rate environment have caused investors to look for investments with attractive returns. Buying the rights to someone else's pension or structured settlement income stream may look like a good alternative to other options because advertised yields from 5.75 percent to 7.75 percent are common.

In a typical transaction, the investor buys an income stream product from a financial salesperson for a specific amount. In return, he receives a specific monthly income for a set number of years. While the yield in such a transaction may be attractive, investors should be aware of the following:

- These products can be expensive. You may encounter commissions of 7 percent or higher.
- Pension and structured settlement income-stream products may or may not be securities and likely are not registered with the SEC. As such, reliable information about these products may be difficult to find and resolving disputes should an investment go sour may also be difficult.
- These products are illiquid, which means that they could be difficult to sell. In the event you need money and want to sell the product, you might not be able to do so or you may only be able to do so at a loss.
- Your "rights" to the income stream you purchased could face legal challenges. It may not be legal to purchase someone's pension. And it may be difficult to legally force the original owner of a pension or structured settlement to forward or assign their income to a factoring company or investor.

Before You Invest

Given these risks and complexities, ask the following questions before you invest:

- **Is the financial professional selling the product registered with a state or federal regulator or with FINRA?** Use the resources below to check the registration status of the salesperson.
 - Visit the SEC's [Investment Adviser Public Disclosure \(IAPD\)](#) website.

- Visit [FINRA BrokerCheck](#) or call FINRA toll-free at (800) 289-9999.
 - Contact your [state securities regulator](#).
 - Contact your state's insurance commission by visiting the website of the [National Association of Insurance Commissioners](#) or calling toll-free (866) 470-6242.
- **How is the salesperson being compensated?** Ask the salesperson how he is compensated and how this impacts the purported rate of return.
 - **Is the salesperson authorized to sell this product?** If registered, ask if the salesperson's compliance department has reviewed the product and allows it to be sold.
 - **What is the reputation of the company selling the product to me?** In addition to checking out the person selling the product, check out the factoring company's record with the [Better Business Bureau](#) and research the firm online and with a financial professional.
 - **What are the tax consequences?** Consult with a tax advisor about the possible tax implications of purchasing pension or structured settlement income-stream products.
 - **What organization is ultimately paying you?** Regardless of who is selling you the product, or the original recipient of the income stream, the ultimate source of payment is likely to be a pension fund (if you are purchasing a pension income stream) or an insurance company (if you are purchasing a structured settlement income stream). You will want to check the financial stability of the organization,

because if that entity goes bankrupt or becomes insolvent, it may stop paying the income stream. Research an organization's [credit rating](#) and [company filings](#).

- **Who is sending the check?** In some cases, instead of receiving checks directly from the pension fund or insurance company, it has been reported that some pension sales arrangements allow for the pensioner to manually forward his or her checks to the investor. As a result, in addition to the risk the investment may be difficult to sell and the risk that the pension fund or insurance company's financial position may deteriorate, investors are exposed to the risk that the original pension holder may refuse to forward checks to the buyer. You should make sure that the contract spells out who will be responsible for sending you the payments.

Whether you are thinking about selling a pension or structured settlement, or buying one from someone else, remember that the risks in doing so are substantial and the safety net if things go wrong may not be very strong. Don't shy away from asking probing questions—and shop around. There may be less risky alternatives to help you achieve your financial objectives.

The Securities and Exchange Commission's Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.