Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Financial Institutions & Insurance Committee

SSB 5561

Brief Description: Concerning restrictions on assignments under UCC Article 9A.

Sponsors: Senate Committee on Financial Services, Insurance & Housing (originally sponsored by Senator Prentice).

Brief Summary of Substitute Bill

· Exempts security interests in certain types of personal injury compensation awards or special needs trusts from the Uniform Commercial Code's prohibition against restrictions being placed on the assignment, transfer, or creation of a security interest in rights related to a promissory note or account.

Hearing Date: 3/28/03.

Staff: Thamas Osborn (786-7129).

Background:

Uniform Commercial Code. The Uniform Commercial Code (UCC), organized in 11 articles, is a model code drafted by the National Conference of Commissioners on Uniform State Laws for the purpose of providing a consistent and integrated framework of rules to deal with commercial transactions. All 50 states have now adopted the UCC. The UCC is set forth in the Revised Code of Washington in the 11 chapters of Title 62A.

Article 9 of the UCC (chapter 62A.9A RCW) governs the creation and operation of security interests in personal property or fixtures. A security interest is broadly defined to include any interest in personal property created by contract that secures payment or other performance of an obligation. Article 9 provides methods of creating and filing a security interest and the manner in which a security interest may be perfected.– Perfection of a security interest is the means by which a secured creditor obtains priority over other creditors who have a security interest in the same collateral.

Article 9 also deals with rules and restrictions relating to the assignment by a creditor (the assignor–) to a third party (the assignee–) of rights related to a promissory note, account, or other security interest. Such assignments are sometimes accomplished via an agreement between the debtor and the original creditor (assignor), wherein the debtor agrees to allow the creditor to assign its rights under the promissory note, account, or security interest to a third party (assignee). The UCC prohibits such agreements from containing terms that require the debtor's consent or which otherwise restrict or condition the assignment of such rights from an assignor to an assignee.

Some members of the insurance industry are of the opinion that this prohibition against restrictions being place on the assignment of security interests, promissory notes, or accounts threatens the tax advantages inherent in "structured settlements" and thus serve as a disincentive to the creation of such settlements.

<u>Structured settlements</u>. In the settlement of large tort claims, damages are often paid by a defendant to a plaintiff in the form of what is called a "structured settlement." In its simplest form, a structured settlement typically involves the initial payment of a lump sum, followed by a series of subsequent smaller payments that are made at specified intervals over a period of years (an "annuity").

This approach to the payment of damages can be advantageous to both parties. Structured settlements are usually paid by an insurance company, which benefits by paying off the obligation in installments over a long period of time, rather than as a single lump sum. The recipient of the proceeds of a structured settlement can benefit as well, since annuities have tax advantages and the receipt of payments over the long term can provide financial security.

It has become commonplace for the recipient to transfer his or her right to receive the annuity to a third party corporation via a contract called a "transfer agreement." In return, the recipient receives a single lump sum payment representing the discounted present value of the annuity.

Structured settlements are regulated under the Structured Settlement Protection Act, chapter 19.205 RCW.

<u>Internal Revenue Code</u>. Under the Internal Revenue Code, certain types of income are exempted from the definition of "gross income" for the purpose of determining one's tax liability.
These exemptions include: (1) amounts received via workmen's compensation for personal injuries or sickness; and (2) the amount of any damages received on account of personal physical injuries or physical sickness, excluding punitive damages. These exemptions are set forth in 26 U.S.C. Sec.104(a)(1) and (2).

<u>Social Security Act</u>. Under the Social Security Act, a person's entitlement to Social Security benefits may be affected by the assets available to that person, including assets available via a trust or which are placed in a trust by a person for the benefit of another. Certain types of special needs trusts and annuities " including certain trusts or annuities created for the benefit of a disabled person " are exempted from consideration as an "asset" for the purpose of calculating Social Security benefits. These exemptions are set forth in 42 U.S.C. Sec. 1396p (d)(4).

Summary of Bill:

The provisions in Article 9 of the UCC *prohibiting* restrictions from being placed on the assignment, transfer, or creation of a security interest in rights related to a promissory note or account *do not apply* to security interests involving certain types of personal injury compensation awards or benefits available under a special needs trust. By eliminating this prohibition and, thus, allowing such restrictions, the bill makes it possible for a structured settlement agreement to contain terms limiting the ability of the beneficiary to later cash out the settlement in lieu of receiving structured annuity payments.

The bill specifies that its provisions do not affect the transfer of structured settlement payment rights under chapter 19.205 RCW.

Appropriation: None.

Fiscal Note: Not Requested.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.