pennsylvania
DEPARTMENT OF HUMAN SERVICES

DATE: **November 16, 2015**

OPERATIONS MEMORANDUM #15-11-01

SUBJECT: Changes to Fair Consideration Provisions when Evaluating Non-Qualified Annuities in Long Term Care (LTC) Cases

TO: Executive Directors

FROM: Inez Titus
Director
Bureau of Operations

PURPOSE

To provide updates to fair consideration provisions for non-qualified annuities owned by applicants, recipients and spouses of applicants or recipients applying for LTC services, including Home and Community Based Services. These policy changes are effective immediately.

BACKGROUND/DISCUSSION

An annuity is a financial instrument providing for a return of principal and interest on an individual's investment. There are two types of annuities: a qualified annuity (part of, or in conjunction with, certain employer-established accounts or individual retirement plans) and a non-qualified annuity (one that is purchased outright by an individual and is not part of a retirement plan, such as a Single Premium Immediate Annuity (SPIA)).

The Third Circuit Court of Appeals recently reached a decision in the Zahner v. Secretary, PA Department of Human Services (DHS) court case. The Court of Appeals essentially changed the definition of "actuarially sound". Prior to the Zahner case, the payment term of a non-qualified annuity had to equal the life expectancy of the annuity's owner. Effective immediately, annuities with payment terms equal to or less than the life expectancy of the annuity's owner are considered actuarially sound.

Non-qualified annuities purchased during the look-back period must be evaluated for fair consideration. In order to be considered a transfer of assets for fair market value, an annuity purchased during the look-back period must continue to meet the following requirements:

- It must be irrevocable and non-assignable; and

- It must provide for payments in equal amounts, with no deferral and no balloon payments made; and
- It must name DHS as the beneficiary in the first position for the total amount of Medical Assistance paid on behalf of the applicant/recipient or must name DHS as the beneficiary in the second position after the community spouse, minor child, or disabled child for the total amount of Medical Assistance paid on behalf of the applicant/recipient; and
- It must be actuarially sound.

Prior to the Zahner decision, in order to be actuarially sound, an annuity had to have a payment term that was equal to the individual's life expectancy. If the annuity term was either shorter or longer than the annuity owner's life expectancy found on the Life Expectancy Tables in LTC Handbook Chapter 440 Appendix D, then the purchase price of the annuity was used to determine an ineligibility period for payment of LTC services.

Effective immediately, due to the Zahner decision, the definition of "actuarially sound" has changed. Annuities will now be considered actuarially sound if the annuity payment term is either shorter than, or equal to, the owner's life expectancy.

Example One: Non-qualified Annuity is Actuarially Sound
Mr. A is 85 years old. He entered the LTC facility on 9/15/XX. He applied for payment of LTC facility services on 10/14/XX. His wife, Mrs. A, is 76 years old. On 10/20/XX, Mrs. A used $50,000 in excess resources to purchase a non-qualified annuity. The CAO used a copy of the annuity contract to verify that the annuity is irrevocable and non-assignable, provides for equal monthly payments, names DHS as beneficiary, and pays out over an 8-year period. The CAO used the Life Expectancy Tables found in LTC Handbook Chapter 440 Appendix D to verify the life expectancy for a 76 year old female is 11.90 years. Because the payment term of the annuity is within Mrs. A's life expectancy, the annuity is actuarially sound. All requirements listed above have been met so fair consideration has been received.

Example Two: Non-qualified Annuity is Not Actuarially Sound
Mr. B entered the LTC facility on 5/12/XX. He applied for payment of LTC facility services on 10/20/XX. Mr. B purchased a $70,000 non-qualified annuity within the look-back period, when he was 81 years old. The CAO used a copy of the annuity contract to verify that the annuity is irrevocable and non-assignable, provides for equal monthly payments, names DHS as beneficiary, and pays

out over a 15-year period. The CAO used the Life Expectancy Tables found in LTC Handbook Chapter 440 Appendix D to verify the life expectancy for an 81 year old male is 7.41 years. Because the annuity has a payment term longer than Mr. B's life expectancy, fair consideration has not been received. The CAO determined the ineligibility period for payment of LTC services by dividing the purchase price of the annuity by the average daily pay rate in effect at the time the case is processed.

NEXT STEPS

1. Review this Operations Memorandum with appropriate staff.

2. Contact your Area Manager if you have any questions.

3. This Operations Memorandum will be obsolete upon incorporation into LTC Handbook Chapter 440.