March 13, 2010

Cynthia Mann
Director
Center for Medicaid and State Operations
7500 Security Blvd.
Baltimore, MD 21244

Re: annuities

Dear Director Mann:

I am writing on behalf of the National Academy of Elder Law Attorneys ("NAELA") in response to a letter dated March 10, 2010, to you from the National Association of State Medicaid Directors ("NASMD") regarding the above-referenced subject.

As CMS has consistently recognized, the standard annuity requires the purchase of a commodity, that is, the annuity, for a specific amount of money from a company in the business of selling such commodities on the open market. The company from which the annuity is purchased is then contractually bound to provide a stream of income to the purchaser for a specified period of time. Once bought, the purchaser no longer owns the resources used to purchase the annuity. If the annuity is irrevocable, the purchaser can no longer reclaim the resources used to complete the purchase, but instead is only entitled to the stream of income for the term of the annuity.

NASMD admits that the irrevocable annuities of which it writes comply with all of the requirements of the Medicaid Act, specifically the Deficit Reduction Act of 2005 ("DRA"), and that the annuities cannot be sold on a secondary market. In 2006, Congress, long aware of the use of annuities as a planning technique in the context of the Medicaid program, enacted several new sections to the Medicaid Act that directly address the purchase of an annuity.

Of significant note, Congress did not eliminate the use of annuities as a method through which income could be preserved for the community spouse. Instead, Congress passed several new sections to the Medicaid Act that seek to preserve income for the community spouse while ensuring that the various states receive any remaining income from the annuity upon the death of the community spouse. These new provisions require that the state be named as first remainder beneficiary, that the annuity be actuarially sound, and that the annuity provide for payments in equal installments.

NASMD now asks CMS to override congressional intent as expressed in the DRA and change the laws governing the Medicaid and SSI programs in order to accomplish what Congress specifically refrained from doing with the DRA—the elimination of annuities in the context of Medicaid. NASMD requests that CMS treat annuities as trusts and, more significantly, that CMS treat the resources used to purchase the annuity as resources of this trust.

NASMD is making this two-part request because it realizes that if an annuity were solely an income item and the purchaser no longer owned the resources used to purchase the annuity but only had a right to the income, an "annuity-trust" would be a trust paying out income only. NASMD seeks to bolster its argument with a reference to the treatment of annuities in the Internal Revenue Code (the "IRC"); however, since the IRC treats annuities differently than does the Medicaid Act, any use of the IRC's methodology in the context of the Medicaid Act would violate the comparability provisions of the Medicaid Act.

As previously stated, CMS has long recognized the economic reality of an annuity. Yet, NASMD asks CMS to ignore this reality and treat the purchase of the annuity as a trust, a treatment that would necessarily encompass the creation of a fiduciary relationship between the annuity company and the owner of the annuity. Not only does this request ignore the realty of the purchase and create potential liability issues for annuity companies of which we are confident those companies would need to be apprised, NASMD's request requires CMS to change the laws governing the Medicaid and SSI program.

Under existing law, the law of which Congress was aware when it passed the DRA, an annuity is an income item. Since the annuity of which NASMD writes is irrevocable and cannot be sold on a secondary market, the purchaser of the annuity no longer owns the resources used to purchase the annuity, only the income. In order to treat the annuity as a resource, because of the comparability provisions of the Medicaid Act, CMS would have to change the regulations governing the SSI program to treat annuities as a resource item. NASMD recognizes this fact in its letter. ("We believe it is time the Secretary specifies that these annuities are trusts and that under the trust rules, the entire purchase price—which must be paid back to the community spouse to avoid a transfer penalty—is an available resource.")

Not only would this request require a change of law in two programs, it would also contradict congressional intent as expressed in the DRA and render the provisions of the DRA functionally meaningless. A community spouse, for instance, would never purchase an annuity that names the state as first remainder beneficiary as part of her CSRA when she could simply purchase a stock without such a requirement?

Finally, far from engaged in a race to obtain a federal court decision that resolves this issue, two federal appellate court decisions already exist that soundly resolve the issue. In *James v. Richman*, 547 F.3d 214 (3d Cir. 2008), the United States Court of

Appeals for the Third Circuit held that the Commonwealth of Pennsylvania could not treat the type of annuity that is the subject of NASMD's letter as a resource. In *Weatherbee v. Richman*, 595 F.Supp.2d 607 (W.D. Pa 2009), *aff'd*, 2009 WL 3792406 (3d Cir. 2009), the third circuit reiterated its holding in the *James* decision and summarily dismissed an argument that the Commonwealth of Pennsylvania was making based upon 42 U.S.C. § 1396p(e)(4).

While we cannot speak for the Court, the third circuit's summary affirmation of the district court's decision in the *Weatherbee* matter is likely a non-precedential decision because the Court believed that it added nothing to the existing body of law and that the *James* decision had soundly resolved the issue. The vast majority of circuit court decisions are non-precedential.

Accordingly, as NASMD correctly recognizes, the existence of federal appellate court decisions on this issue "make[s] federal clarification [by CMS] at [this] point more difficult." In sum, NASMD is asking CMS to ignore congressional intent, to change existing laws governing the Medicaid and SSI programs, and to overrule the third circuit on an issue it has already resolved.

NASMD also mentions promissory notes in its letter. The mention is an aside and it is uncertain what NASMD is asking CMS to say on this issue.

The federal case that NASMD mentions (*Sable v. Velez*, 2009-cv-2813 (D.N.J. 2009), *appeal pending*, 10-1148 (3d Cir. 2010)) involved five plaintiffs at the district court level. Several of the plaintiffs had purchased non-negotiable promissory notes and two of the plaintiffs had purchased negotiable promissory notes. Only the two plaintiffs who purchased negotiable promissory notes are appeal the district court decision.

NAELA position is that the purchase of a DRA-complaint promissory note (a promissory note that complies with the requirements of 42 U.S.C. § 1396p(c)(1)(I)) is not an uncompensated transfer. In addition, NAELA would content that a bona fide, negotiable promissory note cannot be treated as a trust-like device as a matter of law.

A bona fide promissory note is legally valid and made in good faith as a matter of law. A bona fide note is presumed to be negotiable. A negotiable note is treated as a resource item. An item that is otherwise counted as a resource item cannot be analyzed as a trust-like device.

Please do not hesitate to contact me if you have any questions or we can assist you in any way. I can be reached at 732-974-8898 or johncallinan@optonline.net. Thank you for your time and attention to this matter.

Sincerely,

John W. Callinan

NAELA member