The Abuse of Annuities

By Wesley E. Wright and Molly Dear Abshire, as published in the Houston Chronicle Senior Living Section on May 1, 2003.

In the field of Medicaid planning for long-term care, it is disheartening to see annuities being sold to people who do not need them and for whom such a purchase is ill-advised. Annuity sales are often marketed by sales persons who receive a commission from the sale. Often this is done under the pretext that the annuity is ìrequired" by Medicaid, or that it is an effective way of sheltering assets in order to qualify for Medicaid.

An annuity is a type of contract which is typically sold by a life insurance company. It is an investment device whereby a person converts cash assets into a stream of income. The person who is to receive this stream of income is the payee. Annuities may be revocable or irrevocable. In a revocable annuity, the purchaser can cash in the principal. In an irrevocable annuity, the purchaser cannot cash in the principal and is entitled only to the income stream. An ìimmediate" annuity is one where the income stream begins right away. A ìdeferred" annuity is one where the income stream begins at a later date as specified in the contract.

Why is buying an annuity often ill-advised for people looking toward long-term care? First, Medicaid does not require anyone to buy an annuity. In fact, the Texas Medicaid program has very strict rules regarding annuities. Buying an annuity can disqualify an individual or couple for nursing home services financed by Medicaid, unless the annuity meets specific Medicaid guidelines.

Some of the Medicaid guidelines for an annuity are that it be irrevocable and immediate. It must pay out principal and interest in equal monthly installments. The annuity must be structured so that the entire principal is paid to the payee during the payeeís lifetime, using actuarial tables. Also, if the payee is the Medicaid recipient, the annuity must contain a payback provision to Medicaid when the payee dies. Buying an annuity fails to preserve the assets in their original investment vehicle and it locks them into an investment device with an historically low rate of return.

While it is true that buying an irrevocable annuity that meets the Medicaid guidelines does remove cash assets as a barrier to Medicaid eligibility, there are almost always better ways of accomplishing this. One is through ìaggressive monthly gifting." This involves the individual divesting himself of assets by giving them to loved ones. This is done in small increments over a lengthy time period to avoid Medicaid penalties.

When one spouse is in a nursing home and the other spouse remains at home, Medicaid law affords significant financial protections to the spouse at home (i.e., the community spouse). These protections are especially effective if the monthly income (e.g., social security, pensions, etc.) of the community spouse is less than a minimum amount. This minimum amount is currently $2,266.50, and it increases annually. By using a technique known as an ìExpanded Protected Resource Assessment," the elder-law attorney may be able to shelter all of the coupleís assets for use by the community spouse.

Through the ìExpanded Protected Resource Assessment," assets of the couple are preserved in their original form, without having to convert them into a stream of income such as that which an annuity promises. Thus, these assets are available to be shifted into other investment vehicles of the coupleís choice with a much higher rate of return than an annuity.

While there are a few situations where buying an annuity might be appropriate, generally this is not the case in Medicaid planning. Beware of an annuity sales person who insists that an annuity is the only course of direction that will help you.