Institutional Longevity Markets Association

INVESTOR NOTES

Addressing the Medicaid Long-Term Care Funding Crisis: Are Life Settlements the Answer?

With the increasing number of older Americans requiring long-term care, the pressure on the Medicaid system, which is the primary payor for long-term care, is also growing. Medicaid and state budgets have been hit hard by both reduced tax revenues as a result of the economic crisis and growing Medicaid enrollment for an aging population. The aggregate Medicaid shortfall across 46 states for fiscal year 2011 was $121 billion and is growing rapidly. Long-term care costs can run $20,000 per month or more. Without significant reforms or new funding sources, these costs can overwhelm the Medicaid system. Increasingly, state governments are considering new bills to allow seniors and the states to address the Medicaid funding crisis with life insurance.

The treatment of life insurance with respect to Medicaid eligibility can be complex, with many seniors lapsing policies in order to qualify for Medicaid. In several states, including Florida, Kentucky, Louisiana, Maine and Texas, new bills focusing on the role life settlements can play in funding Medicaid long-term care costs were proposed in 2013. Recently, the Texas bill was approved by both the House of Representative and the Senate and now awaits Governor Perry's signature. In the other states, the Medicaid bills appear to be stalled for the moment. Nevertheless, these bills have fostered discussions about the role life settlements may play in funding long-term care.

Under current laws, a life insurance policy is recognized as an asset of the policy owner, the cash value of which counts against the owner when determining Medicaid eligibility. If a policy has more than a minimal amount of cash value (usually in the range of $2,000-$5,000), the excess value must be liquidated and that money spent towards cost of care before Medicaid will cover long-term care costs. Consequently, many seniors applying for Medicaid are forced to surrender or lapse policies.

Under the proposed Medicaid funding laws, however, Medicaid-eligible seniors would not have to surrender or lapse their policies in order to become eligible for Medicaid. The bills provide that the value of life insurance would not count against a senior when determining his or her Medicaid eligibility if the senior elects to enter into a public or private settlement transaction. Under the public option, the senior policy owner would name the state an irrevocable beneficiary of such policy or assign the life insurance policy directly to the state. With respect to life insurance policies with a face amount in excess of $10,000, the senior could pursue the private option and enter into a life settlement transaction addressing long-term care funding. Under either option, the senior policy owner might be able to pass some value from the life insurance policy to his or her estate, assuming, in the case of the public option, that not all of the proceeds are needed for long-term care and to reimburse the state for the premiums it paid. From the state's perspective, these options would defray some of the Medicaid costs that the state would otherwise incur. Questions remain, however, as to how these programs would work in practice.

Under the public option, if the state is named as an irrevocable beneficiary, or if such life insurance policy is assigned to the state, then the state will be entitled to collect from the death benefits paid an amount equal to the Medicaid benefits provided plus any life insurance premiums paid by the state and/or other costs incurred by the state. The remaining balance of the death benefits would be paid to the insured's designated beneficiaries. The bills also authorize the state agencies, to the extent permitted under federal law, to use federal or state funds under the Medicaid program to pay premiums due under these life insurance policies. In order to make the public option available, the states would need to implement a policy servicing program and be responsible for determining how much premium to pay, paying the premiums, confirming the payments were received and applied correctly by the insurance companies and submit death claims. Whether the states wish to take on this burden, or hire a third party to do so, remains to be seen.

The private option looks more like a traditional life settlement, with one key difference. Rather than paying the proceeds from the settlement directly to the policy owner, the sales proceeds would be funded into an escrow account and paid, over time, to a Medicaid approved health care provider selected by the insured. In addition, the lesser of $5,000 or 5% of the face value of the policy could be set aside as a death benefit for the insured's beneficiaries. If any amounts designated for long-term care remain unpaid at the time of the insured's death, then such remaining amounts would also be paid to the insured's beneficiaries. The pending bills provide that the funds for paying long-term care costs must be held in an irrevocable state or federally insured account and the life settlement contract must contain a schedule setting forth the total amount payable, the number of payments to be made and the amount of each payment. Also, all of the marketing materials and sales brochures used by settlement providers and brokers must be filed with and approved by the regulators before they are distributed. Given the small face amount of these policies and the servicing costs, the pool of providers and investors interested in purchasing these policies may be limited.

While these bills may not become law, they serve to highlight the importance of life insurance as an asset and the role that life insurance may play in funding long-term care costs. A number of actors in the life settlement space have focused on this opportunity, but, as noted above, the Medicaid funding bills, if passed, may face several practical challenges that could limit the benefits to the insureds and the states. Nevertheless, these bills do represent an important departure from the existing approach to life insurance and Medicaid eligibility.

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