Memorandum

Date OCT 31 1994

From June Gibbs Brown
Inspector General

Subject The Use of Trusts by Medicaid and Supplemental Security Income Recipients Receiving Third Party Liability Settlements and Awards (A-09-93-00033)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of our final audit report entitled, "The Use of Trusts by Medicaid and Supplemental Security Income Recipients Receiving Third Party Liability Settlements and Awards."

Our national survey of the 51 Medicaid agencies disclosed that in 36 agencies trusts were used by Medicaid and Supplemental Security Income (SSI) recipients to shelter assets. The agencies also reported that the use of these trusts was growing. Although we were unable to determine the financial impact of these trusts on Medicaid nationally, we concluded that the impact on Medicaid of 25 such trusts which we studied in California was significant--there were $3 million in unrecovered program costs. State officials believe the total number of such trusts in California to be much greater than the 25 we studied.

The Congress closed some of the loopholes involving the use of these trusts in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) but permitted exceptions for disabled SSI recipients whose trusts specify that Medicaid will receive its expenses from any trust funds that remain upon the individuals' deaths. The Office of Inspector General believes that the new exceptions contain loopholes which may prevent Medicaid from recovering its expenses. In addition, in order to ensure that Medicaid can recover from liable third parties when trusts are used, States need laws specifically dealing with trusts and Medicaid recipients.

Therefore, we recommend that the Health Care Financing Administration (HCFA) develop (1) legislative proposals to close the loopholes in OBRA '93 to better ensure that trust funds are not drained and, accordingly, are available for Medicaid upon beneficiaries' deaths; and (2) guidelines to assist States in strengthening Medicaid's right to recover when trusts are established by third parties.

The HCFA agreed that the current exceptions contain loopholes and that it could recommend to the Congress that it amend the exceptions in such areas. The HCFA also said that it will provide guidance to States so that they can better recover from trusts established by third parties.

We would appreciate your views and the status of any further action taken or contemplated on our recommendations within the next 60 days. If you have any questions or further comments, please call me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 966-7104. Copies of this report are being sent to other interested Department officials.

To facilitate identification, please refer to Common Identification Number A-09-93-00033 in all correspondence relating to this report.

Attachments

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

THE USE OF TRUSTS BY MEDICAID AND SUPPLEMENTAL SECURITY INCOME RECIPIENTS RECEIVING THIRD PARTY LIABILITY SETTLEMENTS AND AWARDS

JUNE GIBBS BROWN
Inspector General

OCTOBER 1994
A-09-93-00033

SUMMARY

Medicaid is a program that provides medical benefits for recipients with limited income and resources. Normally, recipients who come into possession of substantial assets become ineligible for Medicaid.

However, in a nationwide survey of Medicaid State agencies, we found that some eligible recipients who received large settlements and awards from liable third parties as a result of accidents were able to shelter the assets in irrevocable trusts and retain their eligibility for Medicaid. With these trusts, they were also able to prevent Medicaid from being repaid for medical services related to injuries sustained in their accidents.

These recipients were able to remain Medicaid eligible because the Federal Medicaid law prior to August 1993 was silent about how the assets and income of such trusts would be treated. While Federal Medicaid law was silent, the Supplemental Security Income (SSI) program's eligibility rules effectively excluded assets in such trusts for SSI eligibility, and as a consequence, for Medicaid eligibility in most States.

Our survey of 51 Medicaid agencies (50 States and the District of Columbia (D.C.)) revealed:

- that 36 of the 51, or 71 percent, had encountered the use of irrevocable trusts funded by third party settlements and awards.
- that none of the 36 agencies that had encountered such trusts had records that could identify all those individuals who had used such trusts to qualify for benefits.
- that 23 of the same 36 agencies provided estimates that such trusts numbered between 268 and 338 nationally. The other 13 agencies could not provide an estimate.
- that 18 of the same 36 agencies indicated that, in their opinions, the use of such trusts was increasing.

We were unable to determine the financial impact on Medicaid nationally. However, our analysis of 25 third party liability (TPL) settlements involving trusts in California showed that the impact on Medicaid in that State was significant. For these 25 cases, California obtained repayment for only 35 percent of its Medicaid expenses relating to costs for which third

parties were responsible at the time of settlement. A total of about $1.8 million was not recovered, although sufficient settlement proceeds were awarded. An additional $1.6 million in expenses were incurred after settlement. Potentially, $1.2 million of the $1.6 million could have been paid from the trust funds. Thus, the total cost to the Medicaid program during the period June 1988 through October 1992 for these 25 trusts was $3.0 million ($1.8 million + $1.2 million). In addition, the cost to the SSI program during Calendar Year (CY) 1992 was about $70,000. State officials believe that there are many more such trusts in California.

When the Congress became aware of financial diversion devices used by persons to qualify for Medicaid, it enacted legislation to close the loopholes. Laws were passed to prevent persons from disposing of assets at less than fair market value and from transferring assets which they owned into trusts in order to obtain Medicaid benefits.

The Congress took steps in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), enacted into law on August 10, 1993, to tighten the laws designed to prevent individuals from transferring assets for less than fair market value and into trusts. It provided exceptions that apply to individuals who meet the definition of disabled under the SSI program. The exceptions are allowed if such trusts provide that Medicaid will receive amounts remaining in the trusts (up to the State's Medicaid expenses) upon the deaths of the individuals. We believe that these exceptions contain loopholes which may continue to prevent Medicaid from ever receiving reimbursement for its expenses.

The Congress also took steps in OBRA '93 to strengthen States' rights to recover medical expenses from third parties by requiring that States must have adequate State laws regarding recipients' assignments of their rights. However, our review showed that States had not always been successful in recovering funds when trusts were involved.

Therefore, we recommend that the Health Care Financing Administration (HCFA) develop (1) legislative proposals to close the loopholes in OBRA '93 to better ensure that trust funds are not drained and, accordingly, are available for Medicaid upon beneficiaries' deaths; and (2) guidelines to assist States in strengthening Medicaid's right to recover when trusts are established by third parties.

The HCFA agreed that the current exceptions contain loopholes and that it could recommend to the Congress that it amend the exceptions to limit the use of trust funds to certain well-defined necessities (e.g., health care that is not covered by Medicaid). The HCFA also said that it will provide guidance to States so that they can better recover from trusts established by third parties.

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INTRODUCTION

Background

Medicaid provides medical assistance for certain individuals and families with limited income and resources. It is funded jointly by the Federal Government and the States. Each State (and D.C.) operates its program according to State criteria that vary widely within a broad framework of Federal guidelines, except Arizona which conducts its program as an alternative to Medicaid under a waiver of some basic Medicaid requirements.

Although States generally have broad discretion in determining which groups to cover, certain groups must be covered. One mandatory group is low income individuals receiving cash assistance through the SSI program, a Federal program administered by the Social Security Administration (SSA).

The SSI program was established to provide cash assistance to individuals who have limited income and resources and who are age 65 or older, or blind, or disabled. Effective January 1, 1994, eligibility for Federal benefits has been restricted to those qualified persons who had countable income of less than $446 per month and countable resources of less than $2,000, or in the case of married couples, countable income of less than $669 per month and countable resources of less than $3,000.

In determining SSI eligibility, some income is disregarded, such as the first $20 per month of most income, the first $65 a month in earnings, one-half of earnings over $65 per month, and any support or maintenance assistance based upon need and furnished by a State. Some resources, such as the individual's home, and, within reasonable limits set by regulations, household goods, personal effects, an automobile, and the value of any burial space, are also excluded.

In 38 States[1] and D.C., Medicaid eligibility is directly linked to SSI eligibility. In these States, Medicaid eligibility for SSI recipients is determined using the same methodologies for the treatment of income and resources as is applicable to the SSI program, and if an individual is eligible for assistance under SSI, the individual automatically qualifies for Medicaid. In addition, the same financial rules (although not necessarily the same dollar amounts) are used to determine the eligibility of those persons provided Medicaid at the State's option. In the other 12 States (which are not required by law to provide Medicaid to SSI recipients), the standards, methodologies, and certain nonfinancial criteria for Medicaid eligibility may be different from those that apply to SSI, and, thus, State rules determine Medicaid eligibility.

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[1]All States except Connecticut, Hawaii, Illinois, Indiana, Minnesota, Missouri, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, and Virginia.

Some recipients receive medical care because of an accident or illness for which a third party--for example, a health insurer or someone found by a court to have legal liability--is responsible. States are required by the Social Security Act (the Act) to take reasonable measures to determine the legal liability of third parties to pay for services that Medicaid would otherwise have to pay. If the TPL or the amount of such liability cannot be determined at the time services are provided, the State can provide the medical care under Medicaid and seek recompense from the third party. In addition, Federal law requires Medicaid applicants to assign to the States their rights to medical support and third party payments as a condition of eligibility:

> "...the individual is required...to assign the State any rights...to support...and to payment for medical care from any third party...." (section 1912(a)(1) of the Act)

A trust is a right of property, real or personal, held by one party (a trustee) for the benefit of another (a beneficiary). The ownership rights are controlled by the terms of the trust and the applicable State law. The trustor, or grantor, is the person who creates, and usually funds, the trust. The trustee receives instructions from the trustor as to how the assets in the trust are to be spent, if at all.

Trusts are often set up in hopes that trust assets will not be used to determine eligibility for public assistance under SSI or Medicaid. These trusts were used by some individuals who received personal injury settlements, inheritances, gifts, or life insurance proceeds. However, our study involved only those trusts resulting from TPL settlements and awards.

Scope

Our audit objectives were to determine: (1) if trusts were being used by recipients receiving TPL settlements and awards to shield assets from the Medicaid and SSI programs, (2) if data were available on how much Medicaid was losing, and (3) if Federal legislation was needed to curb abuses in this area.

We reviewed various Federal laws, regulations, and SSA rules pertaining to the eligibility requirements of SSI and Medicaid. We reviewed the Federal law and regulations relating to the recovery of Medicaid expenses from liable third parties. We also reviewed court rulings that dealt with trusts and Medicaid eligibility.

In an effort to determine a national estimate of how many individuals had used such trusts to qualify for Medicaid, we performed a telephone survey of 51 Medicaid agencies (50 States and D.C.). We spoke with Medicaid representatives from eligibility, legal, and TPL recovery sections. Our questions were:

- Are you aware of any Medicaid recipients receiving TPL settlements or awards who have trusts?

- Do you know how many such trusts there are in your State?
- Is there any State law that requires that the State Medicaid agency be notified upon formation of a trust?
- Is there any evidence of a growing trend in the use of such trusts?

We did not, however, verify the information or estimates provided by the representatives of the agencies.

To examine the financial impact in California, we analyzed 25 TPL settlements in which recipients had established trusts. These 25 trusts, which had case settlement dates from June 1988 to October 1992, had been brought to our attention by an employee of the State's Medicaid recovery section for TPL. Our analysis included determining the Medicaid expenses incurred before the settlement and award dates (State's total liens), total settlement and award amounts paid by the third parties, and amount of the State's total liens that it successfully recovered from settlement and award proceeds. We also determined the Medicaid expenses incurred from the settlement and award dates through October 31, 1992 and calculated how much of those expenses would potentially have been available from the trust assets. In addition, we reviewed copies of 13 trusts. The State did not have copies of the remaining 12 trusts.

We determined how each of the 25 recipients qualified for Medicaid--either through the SSI program or under State criteria. For those recipients qualifying under SSI, we obtained data on how much each received in SSI payments during CY 1992.

We reviewed the legislative histories of two amendments to the Act that restricted program eligibility when individuals transferred assets for the purpose of qualifying for Medicaid: (1) section 5(a) of the Parental Kidnaping Prevention Act of 1980 (Public Law [P.L.] 96-611), and (2) section 9506 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272). These two sections of the laws dealt with transferring assets at less than fair market value and establishing trusts, respectively. The transfer of assets provision amended section 1613 of the Act, and the trust provision amended section 1902 of the Act. In addition, we reviewed pertinent parts of OBRA '93 (P.L. 103-66) and its legislative history.

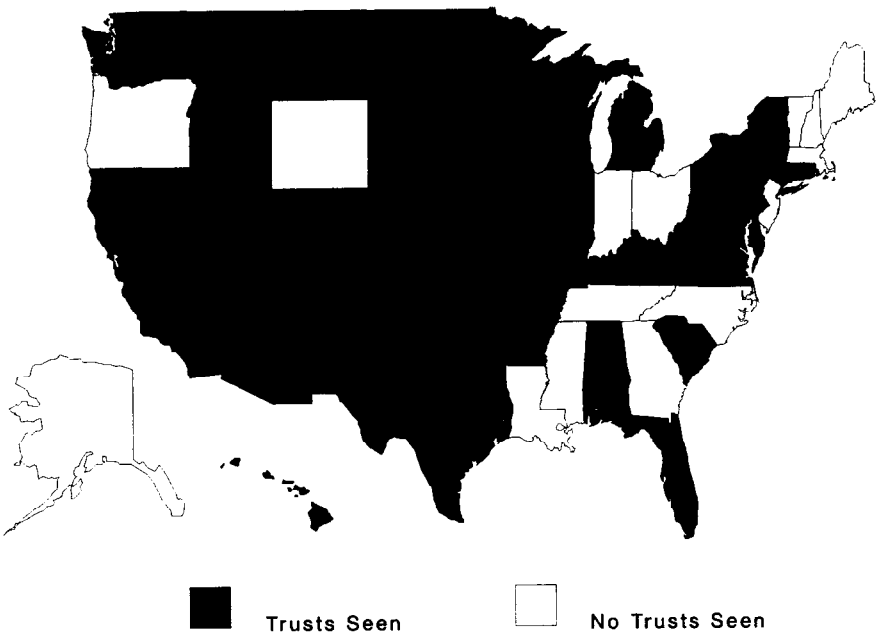
Except for not verifying the States' answers to our survey, our audit was made in accordance with generally accepted government auditing standards. Our field work was performed in Sacramento, California from October 1992 through August 1993.

FINDINGS AND RECOMMENDATIONS

National Survey of Medicaid Programs

In our survey (see the attached EXHIBIT for the results of each Medicaid agency), 36 of the 51 Medicaid agencies in the Nation reported that trusts were being used by recipients of TPL settlements and awards to qualify for benefits.

MEDICAID AGENCIES REPORTING THE USE OF TRUSTS



None of the 36 agencies was able to identify all individuals who had used such trusts to qualify for Medicaid. There was no explicit requirement that such trusts be reported by the recipients to the States, and, even when the States had information about the use of such trusts in some instances, they did not maintain a data base of information to identify those recipients.

Representatives from 23 of the 36 agencies estimated that the number of these trusts in their individual States ranged from 1 to 100. The total estimated number of trusts for all 23 States ranged from a low of 268 to a high of 338. The other 13 agencies could not provide an

estimate. Sufficient data were not available from the States to determine the financial impact on Medicaid nationally.

Representatives from 18 of the agencies indicated that, in their opinions, the use of these trusts was increasing. To support their views, they said they observed articles in trade journals and magazines, saw advertisements about training seminars on the use of such trusts in Medicaid estate planning, and noted the use of standard "boiler plate" language in the trust documents.

Only three States (New York, Minnesota, and California) have enacted laws to prevent these trusts from being used to abuse Medicaid. New York's law, effective April 10, 1992, provided that such trusts were invalid for Medicaid qualifying purposes because they were against public policy. Minnesota's statute treats any provision in a trust created after July 1, 1992 as unenforceable if it makes income or assets unavailable to a beneficiary or applicant of public assistance. California's law, effective January 1, 1993, applies to trusts established for the benefit of minors or incompetent persons. It requires that: (1) the State be notified in advance of court hearings, (2) the terms of any trust be court approved, and (3) the Medicaid liens be fully satisfied before funding the trusts.

Impact in California

Our analysis of 25 TPL cases involving trusts revealed that the impact on Medicaid in California was significant. For these 25 cases, California recovered only 35 percent of the total Medicaid expenses relating to costs incurred before the settlement dates. The 25 recipients had incurred Medicaid costs of about $2.7 million. Although a total of $18.1 million had been awarded to the 25 recipients, the State was repaid only about $900,000 of its $2.7 million of costs, or $1.8 million less than it should have received.

The State sought to recover more of its expenses, but attorneys for recipients argued that there were no funds belonging to those recipients from which the State could be paid. The State's only option was to initiate legal action to recover from the trust assets, an approach not taken because the State believed it would likely not be successful.

Because the recipients remained eligible for Medicaid, the program incurred additional costs of about $1.6 million after the settlements. Potentially, $1.2 million could have come from the trust assets to repay the State and Federal governments. Thus, the Medicaid program in California lost a total of $3 million ($1.8 million + $1.2 million) during the period June 1988 through October 1992 for these 25 cases, or an average of $120,000 per case, because of the use of the trusts.

Eighteen of the 25 recipients qualified for Medicaid by virtue of their SSI eligibility. These 18 received $69,654 in SSI benefits during CY 1992. The remaining seven qualified under the State's criteria.

It was likely that more than 25 individuals in California had used such trusts to qualify for Medicaid between June 1988 and October 1992, but we were unable to determine how many. Like other States, California did not maintain records that could be used to determine how many individuals had such trusts. The source for the 25 was a personal list kept by one employee of the Medicaid's recovery section for TPL. We were unable to use other means to quantify all such trusts in California. However, this State representative informed us that between January 1, 1993, the effective date of the State's new law that required reporting of trusts for minors and incompetents, and April 30, 1993 (only 4 months), there had been 34 such trusts reported to its Medicaid program.

An Actual Trust Involving a TPL Settlement

The actual case of John Doe (a fictitious name) demonstrates how a trust works. In 1985, John, then a 30-year-old male, sustained significant injuries in an accident. John was eligible for Medicaid, and Medicaid covered his medical needs.

He subsequently filed suit against others who allegedly were responsible for his injuries. The case was settled in court in December 1988. The settlement provided for an initial cash payment of $225,000, certain future payments, and establishment of a trust. The present value of the total settlement, as determined by the State, was $464,000.

California incurred $146,180 in Medicaid expenses prior to settlement as a result of John's accident. However, it collected only $22,185 as repayment of these expenses. Since the settlement proceeds were put into the trust, they were not available to satisfy the State's lien (although the attorney's fee of $168,914 and legal costs of $41,716 were paid in full). John's trust document specified that:

- The proceeds were intended to provide for special needs not met by public assistance programs.
- The special needs included medical and dental expenses, special equipment, training, education, rehabilitation, treatment, travel, and recreational needs.
- No part of the trust funds was subject to a claim by any Government agency.
- If the existence of the trust rendered John ineligible for SSI or other Government benefits, the trustee could terminate the trust and distribute the assets.
- If John died, the assets would be distributed to his heirs (Medicaid would get nothing).

- No court supervision of the trust was required.

Additional Medicaid expenses for John after the settlement date totaled $7,900. John did not qualify for SSI, however, as his income (primarily from Social Security, a countable item) exceeded the maximum allowable amount.

Federal Law Prior to OBRA '93

There were no provisions in Federal law or regulations that directly addressed the use of trusts created by third parties in determining SSI or Medicaid eligibility. The Medicaid law dealt with trusts created by an individual or the individual's spouse (other than by will) under which the individual was the beneficiary of all or part of the trust payments:

> "...a 'medicaid qualifying trust' is a trust, or similar legal device, established (other than by will) by an individual (or an individual's spouse) under which the individual may be the beneficiary of all or part of the payments from the trust and the distribution of such payments is determined by one or more trustees who are permitted to exercise any discretion with respect to the distribution to the individual." (section 1902(k)(2) of the Act)

The law provided that for purposes of Medicaid eligibility the amount deemed available to the beneficiary from a Medicaid qualifying trust would be the maximum amount of payments that may be permitted under the terms of the trust, assuming the full exercise of discretion by the trustee (without regard to the actual distributions):

> "In the case of a medicaid qualifying trust...the amounts from the trust deemed available to a grantor...is the maximum amount of payments that may be permitted under the terms of the trust to be distributed to the grantor, assuming the full exercise of discretion by the trustee or trustees for the distribution of the maximum amount to the grantor." (section 1902(k)(1)of the Act)

Since the TPL trusts were established by third parties and not the individual or the spouse, they were usually not considered Medicaid qualifying trusts by the courts.

The SSI regulations, applicable in most States for determining Medicaid eligibility, defined resources as cash, liquid assets, or other property rights:

> "...resources means cash or other liquid assets or any real or personal property that an individual (or spouse, if any) owns and could convert to cash to be used for his or her support and maintenance." (20 Code of Federal Regulations (CFR) 416.1201(a))

The regulations also added that:

> "If the individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource. If a property right cannot be liquidated, the property will not be considered a resource of the individual (or spouse)." (20 CFR 416.1201(a)(1))

However, the regulations were silent on the treatment of trusts in determining SSI eligibility. Instead, a series of policy interpretations by SSA, called the Program Operations Manual System (POMS), were relied upon to decide eligibility.

The SSA policy was that a trust was treated as a resource when an individual was legally empowered to revoke the trust and use the principal for his own support and maintenance. The policy statements instructed eligibility analysts not to count property held in trust as a resource of the claimant if access to the property was restricted. The POMS states that:

> "If the claimant/beneficiary's access to the trust principal is restricted (e.g., only the trustee or court, etc., can invade the principal), the principal is not a resource to the claimant."
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> * * * * *
>
> "If the beneficiary has unrestricted access to the principal of the trust, it is a resource...."
>
> "The authority for discretion by the trustee in the use of trust funds, including invasion of the principal for support and maintenance of the beneficiary, does not mean that the principal is available to the claimant/beneficiary and, as such, is not a resource." (section 01120.105A2)

Regarding trust income, the POMS provides that if the beneficiary has a right to income from the trust as it accrues, it is income to him or her, and if no right exists, it is not income:

> "1. If the claimant/beneficiary has a right to the income from the principal of the trust as it becomes available (whether or not it is applied for his use on a current basis), it is income to him as it becomes available....
>
> "2. If the claimant/beneficiary has no right to the income from the trust principal and the income is added to the principal, then the earnings from the trust principal are not income to the claimant for SSI purposes." (section 01120.105B)

For recoveries from liable third parties, the Medicaid law provides that beneficiaries must assign their rights to third party payments as a condition of eligibility:

> "...the individual is required...to assign the State any rights...to support (specified as support for the purpose of medical care by a court or administrative order) and to payment for medical care from any third party...." (the Act, section 1912(a)(1))

However, the law remains silent on how Medicaid can recover if the third party or someone legally acting for the beneficiary establishes a trust.

How Trusts Were Created to Circumvent the Eligibility Rules

Trusts were carefully crafted so that the eligibility rules did not apply to the trust assets and income. This task was accomplished by having four distinctive features in the trust:

- The proceeds that went into the trust were never received by the beneficiary or his or her representative.
- The trustee (the person agreeing to manage the property) was never the beneficiary.
- The trustee must have had absolute discretion (within the terms of the trust) concerning taking monies out of the trust.
- Trust monies could not be used to buy food, clothing, shelter (because these are the purposes of the SSI cash assistance payments), anything that can be so converted, or medical benefits covered by Medicaid.

These features were designed to defeat both resource and income treatment by avoiding the reach of the SSI rules.

Under SSI rules, a trustee must have absolute discretion over trust assets in order for the assets not to be considered income to a recipient, and payments may not be made from trust assets for food, shelter, or clothing. This leaves a fairly long list of trust payments that appear to be permissible--for example, medical care, home attendants, and rehabilitation care for which Medicaid will not pay, as well as travel, recreation, training, education, and compensation for special care given by friends or relatives.

The trust documents stated that the intent of the one who transferred the property (the trustor or grantor) was that the assets were not to be used to supplant SSI or Medicaid benefits but only to supplement them. Clear instructions were given to trustees to continue to use public benefits, particularly SSI and Medicaid, for the essentials of food, clothing, shelter, and medical care.

Thus, the trusts were designed so that beneficiaries did not legally own the assets, had access to less than the maximum amounts of income permitted for SSI and Medicaid eligibility, and did not receive funds intended for medical needs provided by Medicaid. As a result, the recipients were usually Medicaid eligible.

States' Challenges in the Courts

At least three State agencies challenged these types of trusts in courts. The State of Hawaii was successful in its challenge, but the States of Connecticut and Oklahoma were not.

In a 1991 decision, the Supreme Court of Hawaii decided in the case of Barham v. Rubin, 816 P.2d 965 (Hawaii 1991) that a personal injury settlement that was used to create a trust for a Medicaid applicant was a resource of the applicant. In addition, the court said that the trust was a Medicaid qualifying trust. The court's view was that to allow the applicant to shelter assets and remain on Medicaid would violate the spirit and intent of Medicaid laws.

In the Connecticut case (Forsyth v. Rowe, Conn. Super. Ct., Nos CV91-0396327S, CV92-0505596, 1992 WL 293193, October 13, 1992), the court determined that a trust funded from money received from a personal injury settlement was not a Medicaid qualifying trust and, thus, not a resource of the applicant. The court said that the statute clearly defined a Medicaid qualifying trust as one established by an applicant or his spouse and that, in this instance, the actions of the conservator were not legally attributable to the applicant.

In the Oklahoma case (Trust Company of Oklahoma v. State of Oklahoma, 825 P.2d 1295 (Okl. 1991)), the Oklahoma Supreme Court ruled that a trust was not an available resource. The court decided that the trust was not a Medicaid qualifying trust because the grantor of the trust was the liable third party.

Congressional Action in Limiting Program Eligibility in Similar Instances

For two other devices used by persons to qualify for Medicaid, the Congress restricted eligibility when individuals: (1) disposed of assets at less than fair market value and (2) established trusts and transferred assets to those trusts.

Disposing of Assets at Less Than Fair Market Value. In 1980, the Congress provided, in section 5(a) of P.L. 96-611, specific Federal criteria in the Act to include assets as a resource for purposes of SSI eligibility that were owned by an individual or his/her spouse and disposed of at less than fair market value within 24 months prior to applying for eligibility.[2]

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[2]The Medicare Catastrophic Coverage Act of 1988 (MCCA) repealed the SSI transfer rules, revised the Medicaid transfer rules, and limited the applicability of the transfer rules to individuals receiving nursing facility benefits. The MCCA required States, effective July 1, 1988, to include as a resource those assets (including a home which was previously exempt) transferred at less than fair market value within 30 months prior to the individual's application for nursing facility benefits.

In addition, it allowed States to do the same for Medicaid eligibility. The Congress also provided that:

> "Any transaction...shall be presumed to have been for the purpose of establishing eligibility...unless such individual or eligible spouse furnishes convincing evidence to establish that the transaction was exclusively for some other purpose." (section 1613(c)(2) of the Act)

The legislative history of the transfer provision provides an insight into why the Congress sought to impose this restriction on Medicaid eligibility:

> "The Committee is concerned that persons with substantial resources may be able to receive medicaid benefits by purposefully transferring their valuable assets in order to qualify for medicaid without receiving in fair exchange money that they could live on or goods and services relevant to their support. To the extent that such abuse of the medicaid program occurs, the Committee's bill would provide States with two differential authorities for addressing the problem." (Report to the House of Representatives by the Committee on Interstate and Foreign Commerce, section 31 of H.R. 4000, Medicare and Medicaid Amendments of 1980)

In congressional discussion before the full House of Representatives, a senior Congressman from Texas stated that:

> "...the welfare officers from my State have written me examples of the type of abuse that has been going on in this area for many years, and what is true in my State I am sure is true of Oregon, New York, Michigan, and Illinois."
>
> "A lot of people are taking advantage of our laws by transferring huge sums of money, $25,000, $50,000, $100,000, in assets and then qualifying for medicaid. That costs the Treasury. That is not hurting the poor people. That is the rich and well-off taking advantage of our laws. We ought to tighten it up." (Congressional Record - House of Representatives, December 13, 1980, page 34135)

The Congress' concern in enacting the limitation on transfers at less than fair market value was to prevent the wealthy from disposing of assets by gifts or sales in order to become eligible for Medicaid benefits to which they would otherwise not be entitled.

Establishing Trusts and Transferring Assets to Those Trusts. In the second instance, the Congress placed restrictions upon voluntary transfers of assets to trusts for the purpose of enabling persons making the transfers to qualify for Medicaid. It called these trusts "Medicaid qualifying trusts."

The Committee on Energy and Commerce strongly stated its position on the use of these trusts:

> "It has come to the attention of the Committee that some attorneys and financial advisors have suggested to their affluent clients that, as a matter of estate planning, they consider placing most of their assets into a specially designed irrevocable trust."
>
> * * * * *
>
> "The Committee feels compelled to state the obvious. Medicaid is, and always has been, a program to provide basic health coverage to people who do not have sufficient income or resources to provide for themselves. When affluent individuals use Medicaid qualifying trusts and similar 'techniques' to qualify for the program, they are diverting scarce Federal and State resources from low-income elderly and disabled individuals, and poor women and children. This is unacceptable to the Committee." (Committee Report, Committee on Energy and Commerce, H.R. 3101, page 71)

The Committee sought to prevent individuals and their spouses from transferring their own assets into trusts so that they could qualify for Medicaid. It indicated that it did not intend to disapprove of trusts set up solely for disabled children when those trusts were established by others and could not benefit the grantor. This situation would apply, for example, if trusts were established by grandparents who were under no obligation to provide support for the child but chose to use a trust to furnish additional benefits for their disabled relative.

The congressional purpose for prohibiting Medicaid qualifying trusts was the same as that behind banning transfers without fair consideration. The Congress sought to prevent wealthy individuals, otherwise ineligible for Medicaid benefits, from making themselves eligible by creating trusts that preserve assets for their heirs.

The Congress Closed the Loophole for Many Individuals but Provided Exceptions for SSI Recipients

In response to reported abuses in the use of trusts, the Administration proposed to close the loophole that allowed recipients with certain trusts to be Medicaid eligible in the Fiscal Year (FY) 1993 Budget Bill (H.R. 2264). After extensive deliberations, the Congress provided in section 13611 of OBRA '93 that individuals would generally be unable to continue to use trusts to shield their assets and income in order to qualify for Medicaid even when they are established by a third party, such as a court.

However, section 13611(b) of OBRA '93 added two exceptions for disabled individuals qualifying for SSI. The first exception applies to trusts established by a parent, grandparent, legal guardian or a court and which provide that upon the death of the individual the State

would receive from any remaining trust assets the amount of the medical assistance payments it made on behalf of the recipient:

> "(d)...(4) This subsection shall not apply to any of the following trusts:
>
> > "(A) A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1614(a)(3)) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this title."

A second exception was granted if the trust was established and managed by a nonprofit association:

> "(d)...(4)...(C) A trust containing the assets of an individual who is disabled (as defined in section 1614(a)(3)) that meets the following conditions:
>
> > "(i) The trust is established and managed by a non-profit association.
> >
> > "(ii) A separate account is maintained for each beneficiary of the trust, but for purposes of investment and management of funds, the trust pools these accounts.
> >
> > "(iii) Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in section 1614(a)(3)) by the parent, grandparent, or legal guardian of such individuals, by such individuals, or by a court.
> >
> > "(iv) To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this title."

The Congress Sought to Strengthen States' Recovery Rights

To strengthen States' rights to third party payments, the Congress made other changes in OBRA '93. It added new language to the Act (amending section 1902(a)(25)) that provided that State plans must have appropriate laws in effect so that they acquire the rights to payments from liable third parties:

"(I) that to the extent that payment has been made under the State plan for medical assistance in any case where a third party has a legal liability to make payment for such assistance, the State has in effect laws under which, to the extent that payment has been made under the State plan for medical assistance for health care items for services furnished to an individual, the State is considered to have acquired the rights of such individual to payment by any other party for such health care items or services...." (section 13622(c)(3) of OBRA '93)

Abuses May Continue

We believe that there are three areas that are cause for concern: (1) trust funds of disabled individuals who qualify for the exceptions could be spent so that the assets are depleted, (2) trust funds could be retained by the trusts upon the deaths of recipients, and (3) States may not have appropriate laws as required by section 1902(a)(25) of the Act.

How Trust Funds May Be Spent. The OBRA '93 provisions provide that the excepted trusts are to be for the benefit of disabled individuals. As previously noted above, the first added exception simply stated that the trust be established for the "...benefit of such individual...." Similarly, the second exception for trusts which are established and managed by a nonprofit association provided that "Accounts in the trust are established solely for the benefit of individuals who are disabled...."

There are a variety of questionable uses of trust funds which can benefit the individuals. For example, trust funds could be used to pay for luxury homes and extravagant vacations. Besides the disabled individuals, guardians may also indirectly enjoy the individuals' benefits by virtue of being with them and sharing the assets of the trusts. Trust funds could be depleted in another way by paying guardians large sums for caring for the disabled individuals.

This situation would be possible because Medicaid has no statutory right to approve trust expenditures. Thus, the trust assets could be squandered without affecting Medicaid eligibility. Even though the trusts may provide that Medicaid is to be repaid from remaining trust funds when disabled recipients die, the trusts could be depleted and there would be no remaining funds.

When Disabled Die. Medicaid may not receive its reimbursement upon death of the trust beneficiary because of another loophole. The second exception (i.e., trusts which are established and managed by nonprofit associations) allows the remaining trust funds to be retained by the trust, effectively precluding Medicaid from being repaid. The exception states that:

"To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State...." (emphasis added)

It is conceivable, then, that trusts could be crafted so that, upon the beneficiary's death, the remaining funds are to be kept for other purposes and are not to be made available for payment to the State.

States Need Laws Specifically Dealing with Trusts. As explained earlier, section 1902(a)(25) of the Act requires that States have laws regarding assignment of recipients' rights. However, this section does not specifically mention trusts. Our review has shown that States may not have adequate laws dealing with trusts. Without appropriate laws, States may not be aware that trusts have been created and may not be able to recover from the liable third parties before settlements have taken place. To be effective, such trust laws should have two features: (1) notification to the Medicaid agency prior to third party settlements that involve trusts and Medicaid recipients, and (2) substitution of Medicaid for the recipient's rights in regards to any payments from liable third parties.

Conclusion and Recommendations

In our nationwide survey, most of the Medicaid agencies reported that they had seen recipients in their States who had received TPL settlements or awards use trusts in order to remain Medicaid eligible. None of the agencies had means to identify all such trusts. Many expressed opinions that the trusts were increasing in use. Although we were unable to determine the national impact on Medicaid, the loss of program funds in California was significant. Losses occurred when the State did not receive its reimbursement at the time of settlement and continued as recipients were legally allowed to remain eligible for benefits.

The Congress restricted program eligibility in other similar instances (see pages 12 and 13 regarding disposal of assets at less that fair market value and Medicaid qualifying trusts) and its actions in OBRA '93 corrected some abuses in the use of trusts, but we believe that additional changes need to be made.

We recommend that HCFA develop: (1) legislative proposals to close the loopholes in OBRA '93 to better ensure that trust funds are not drained and, accordingly, are available for Medicaid upon beneficiaries' deaths, and (2) guidelines to assist States in strengthening Medicaid's right to recover from trusts established by third parties.

HCFA's Comments

The HCFA agreed that the exceptions in the new law contain loopholes (e.g., there are no limits on how trust funds may be spent). It indicated that recommendations could be made to the Congress to amend the exceptions limiting the use of trust funds to certain well-defined necessities (e.g., health care that is not covered by Medicaid).

The HCFA also agreed to take appropriate action to strengthen Medicaid's right to recover from trusts established from third party settlements. The HCFA said that it was developing Medicaid guidelines for issuance to the States which would improve States' abilities to include trusts as countable assets for purposes of Medicaid eligibility and to recover benefits paid when third party settlements have occurred.

It was HCFA's belief that States currently have sufficient authority to recover Medicaid benefits before settlement monies are placed in trusts and after trusts have been established. It cited a TPL settlement situation in Alaska to support its view regarding States' abilities to obtain payments before trusts are established. The HCFA indicated that the provisions in sections 1912(a)(1) and 1902(a)(25) of the Act were sufficient for States to recover from trusts and that since States hold the rights to payments they can recover from the liable third parties.

The HCFA also pointed out that under section 1917(d) of the Act (a new provision added by OBRA '93) trusts established by others acting at the applicant's/recipients's request on his behalf were incorporated into the law.

The HCFA proposed that our report contain an expanded discussion on the statutory history of transfers and trust provisions. It also said that the footnote on page 12 should be moved and revised to more accurately reflect the law. The HCFA's comments, dated June 30, 1994, appear as an appendix.

OIG's Comments

Regarding HCFA's belief that States currently have sufficient authority under sections 1912(a)(1) and 1902(a)(25) to recover from trusts, we found that States had not used these sections to recover from trusts once they had been established and settlements had been finalized. According to State attorneys in two States, it is extremely difficult, if not impossible, to get courts to set aside a third party's settlement after a trust has been created unless the State had appropriate trusts laws that were not followed by the parties involved. The State attorneys advised us that they knew of no cases where courts had done this after settlements had been put in trusts. The State attorneys were also of the opinion that State trust laws should require: (1) notification to the Medicaid agency prior to any third party settlements that involve trusts and Medicaid recipients, and (2) substitution of Medicaid's rights in regards to any payments from liable third parties.

With respect to the new section 1917(d) cited by HCFA, the cited section deals with determining Medicaid eligibility, not assignment of rights.

Regarding HCFA's suggestion that our report contain an expanded discussion of the statutory history of provisions dealing with transfers and trusts, we considered HCFA's suggestion but do not believe that the expanded discussion is needed.

We have revised the report to incorporate HCFA's technical comments as appropriate. With respect to HCFA's suggestion to move our footnote on page 10 and revise the wording, we believe that the material is more appropriately presented as a footnote. However, we revised the footnote to more clearly describe the changes in the law.

RESULTS OF MEDICAID AGENCY SURVEY ON USE OF TRUSTS

Medicaid Agency	Reported Use of Trusts	Estimated Number of Trusts	Provided No Estimate	Reported Increase in Use
Alabama	X		X	
Alaska				
Arizona	X	35		X
Arkansas	X	8-10		X
California	X	25 (Note 1)		X
Colorado	X	12		
Connecticut	X	24-36		X
Delaware	X	12		X
District of Columbia	X		X	X
Florida	X	6		
Georgia				
Hawaii	X	1		
Idaho	X	2		
Illinois	X		X	
Indiana				
Iowa	X		X	
Kansas	X	12		X
Kentucky	X	8-10		X
Louisiana				
Maine				
Maryland	X		X	X
Massachusetts				
Michigan	X		X	X
Minnesota	X		X	
Mississippi				
Missouri	X		X	
Montana	X		X	
Nebraska	X	4		X
Nevada	X	7-8		X
New Hampshire				
New Jersey				
New Mexico	X	10-12		X
New York	X	12	—	—
Subtotals this page	24	178-197	9	13

RESULTS OF MEDICAID AGENCY SURVEY ON USE OF TRUSTS

Medicaid Agency	Reported Use of Trusts	Estimated Number of Trusts	Provided No Estimate	Reported Increase in Use
Subtotals brought forward	24	178-197	9	13
North Carolina				
North Dakota	X	6		
Ohio				
Oklahoma	X	4-5		X
Oregon				
Pennsylvania	X	50-100		X
Rhode Island	X	10		
South Carolina	X		X	
South Dakota	X	1		
Tennessee				
Texas	X		X	
Utah	X	3		X
Vermont				
Virginia	X	10		
Washington	X	6		X
West Virginia	X		X	
Wisconsin	X		X	X
Wyoming	—	—	—	—
Totals	36	268-338	13	18
		(Note 2)		

Note 1: Twenty-five actual trusts were identified by the TPL recovery section in California.

Note 2: Twenty-three agencies provided estimates on the number of such trusts. Their estimates ranged between 268 and 338 nationally.

APPENDIX

DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care Financing Administration

Memorandum

Date JAN 30 1994

From Bruce C. Vladeck
Administrator

Subject Office of Inspector General Draft Report: "The Use of Trusts by Medicaid and Supplemental Security Income Recipients Receiving Third Party Liability Settlements and Awards" (A-09-93-00033)

To June Gibbs Brown
Inspector General

We reviewed the above-referenced draft report which examined the use of special needs trusts to shelter assets from the Medicaid and Supplemental Security Income programs. (1)

Our comments are attached for your consideration.

Thank you for the opportunity to review and comment on this draft report. Please advise us if you would like to discuss our comments at your earliest convenience.

Attachment

(1) Office of Audit Services note -- Comments have been deleted at this point because they pertain to material not included in this report.

Health Care Financing Administration (HCFA) Comments on Office of Inspector General (OIG) Draft Report, "The Use of Trusts by Medicaid and Supplemental Security Income (SSI) Recipients Receiving Third Party Liability (TPL) Settlements and Awards" (A-09-93-00033)

(1)

HCFA Response

We concur with the recommendation to take appropriate action to strengthen Medicaid's right to recover from trusts established from third-party settlements. We are currently developing Medicaid guidelines, in the form of State Medicaid Manual issuances, for implementing OBRA 93 provisions. The provisions are intended to prevent individuals from improperly transferring assets into trusts in order to qualify for Medicaid, and to strengthen States' rights to recover medical expenses when other insurance is liable for such expenses. We believe that release of these guidelines, which will interpret and clarify the OBRA 93 provisions, will improve States' abilities to include these trusts as countable assets when determining Medicaid eligibility and seek recovery of benefits paid when third-party settlements exist.

(1)

(1) Office of Audit Services note -- Comments have been deleted at this point because they pertain to material not included in

States currently have the ability to obtain repayment of correctly paid Medicaid benefits prior to settlement money from a third party being placed in a trust. For example, in a case in Alaska, the State was reimbursed for all of a Medicaid recipient's medical care before settlement money from an accident was placed in a trust. The trust was established to ensure continuation of rehabilitative services (the patient was severely disabled in the accident), and it was agreed that Medicaid would begin paying for ongoing medical care from that point on.

Technical Comments

- We believe that an expanded discussion of the statutory history of transfers and trust provisions would provide a context for OIG's findings, and would be a very helpful addition to the report. As stated in the report, the first attempt to close off transfer loopholes was contained in Public Law 96-611, in which the Supplemental Security Income (SSI) statute was amended as the route to correct a perceived Medicaid problem. The next relevant amendments were included in section 132 of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act, which essentially turned the bulk of the transfer of assets provisions over to the Medicaid program to manage, and gave States the option to impose liens on the real property of certain Medicaid recipients in institutions.

  The next statutory change was enacted in section 9506 of Public Law 99-509, the Consolidated Omnibus Budget Reconciliation Act, which made persons with "Medicaid qualifying trusts" ineligible for Medicaid. The report should note these changes since they represent a break with the past in that persons eligible for SSI could nevertheless be ineligible for Medicaid if they violated these Medicaid-only rules.

  A further statutory change in this policy area was enacted in Public Law 100-360, the Medicare Catastrophic Coverage Act, which is mentioned in footnote 2 on page 12 of the report. We suggest moving the footnote into the main text of the report since it marked a major change in law regarding transfers. (In fact, some claim it sparked the growth of the new legal field called "elder law.")

- Under the Treatment of Trusts provision of OBRA 93, in most, if not all, of the California examples used in the report, the individual would be found to be ineligible for further medical assistance. But the State can, under the assignment of rights provision of section 1912, attach any settlement from an insurance company where the accident causing settlement and the establishment of a trust to shelter the settlement were done prior to a redetermination and finding of ineligibility because of income from the trust(s).

- We note that 18 of the 25 cases reviewed onsite in California were SSI cases. The report notes that the scope of the review did not include making recommendations to the Social Security Administration (SSA). We would welcome clarification on why a companion report was not issued to SSA.

- Summary, page 1, second full (unindented) paragraph, says that the Medicaid law was silent about how to treat the assets and income from a third party settlement that has been placed in a trust. This paragraph should make it clear that OIG conducted its survey and based this conclusion on the laws in effect prior to
OBRA 93.

- Summary, page 2: The third full paragraph should say that in OBRA 93, Congress tightened the laws designed to prevent individuals from transferring assets for less than fair market value and into trusts. That is because the Medicaid statute already contained provisions designed to discourage both transfers and trusts, and OBRA 93 was intended to strengthen these provisions.

  Also, the last sentence should refer to the exceptions for individuals who meet the definition of "disabled" under the SSI program, whether or not they are actually recipients of SSI.

  In the fourth paragraph, the first sentence should refer to the exceptions which apply to disabled individuals, since there are two which specifically apply to them.

- Page 1: The last sentence in paragraph 3 should reflect more current SSI eligibility levels: $446 a month in income and $2000 in resources as of January 1.

- Page 1: Both the introduction and background discussion states that eligibility for SSI automatically confers Medicaid eligibility in most States. This statement should be qualified, since there are 12 States which, under the authority of section 1902(f) of the Social Security Act (the Act), are not required to provide Medicaid to SSI recipients. In the last paragraph, line 4 should refer to the treatment of income and resources under SSI. Line 10 should be revised as follows: "12 States, the standards, methodologies, and certain non-financial criteria for Medicaid eligibility may be different from those . . ."

- Page 5: In the second full paragraph, the second sentence should be revised as follows to reflect the fact that section 1917(c), prior to OBRA 93, could have been interpreted to require that an applicant or recipient report a trust

established for his or her benefit by a third party:[1] "There was no explicit requirement that such trusts be reported . . . ."

- Page 6: The fourth full paragraph says that the State's only option was to initiate legal action to recover from the trust assets, an option that the State thought would not be successful. We believe that the law provides another, better option. That is, if the injured individual is Medicaid eligible or has applied for Medicaid before the date of a settlement, that applicant or recipient has to have assigned to Medicaid, as a condition of eligibility, all of his rights to payments for medical care from any third party. If a third party has settled with a Medicaid applicant or recipient by setting up a trust that will benefit the applicant/recipient, then the third party has settled with the wrong party. As such, a State can pursue the third party, since it is Medicaid that holds the right to payment and not the individual.

  Additionally, the State might be able to pursue the plaintiff and the trust on the basis that the plaintiff has cooperated in diverting funds away from Medicaid after he or she has assigned the right to those funds to the State.

- Page 8: The last sentence states that since TPL trusts were established by third parties and not the individual or spouse, they were usually not considered to be Medicaid qualifying trusts. Was it the States that did not consider them as Medicaid qualifying trusts or the courts?

- Page 10: The first full (unindented) paragraph should say in line 1 that the Medicaid law provides that beneficiaries must assign their rights as a condition of eligibility. This revision is necessary for clarity, since items 1 and 2 above this paragraph discuss SSI rules.

  Also, this page says that section 1912 requires an applicant to assign rights. However, the second (unindented) paragraph says that the law remains silent on how Medicaid can recover if a third party or someone legally acting for the beneficiary establishes a trust. The statute is not actually silent, since section 1912 gives the State the right to pursue the third party, regardless of any agreement that has been reached between the beneficiary and the third party. In addition, section 1917(d), as enacted by OBRA 93, now counts trusts that have been established for an applicant or recipient by another person or entity acting at the applicant/recipient's request or on his behalf. Under section 1917(d)(2)(A), an individual is considered to have established

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[1]In the notice of proposed rulemaking for the Medicaid qualifying trust provision, HCFA took the position that a third party stood in the place of an applicant or recipient if the third party established a trust on behalf of or at the behest of an applicant or recipient.

a trust if his assets are used to form some or all of the corpus and if any of a number of enumerated people or entities have established the trust in his place, on his behalf, or at his direction or request. The new section 1917(e) of the Act states that income or resources which an individual is entitled to receive but does not because of the action of another person or entity are still considered to be the individual's income or resources.

In addition, the bullets on page 10 say that trusts have been created so that eligibility rules would not apply. One characteristic of these trusts is that a trustee must have "absolute discretion" concerning taking money out of the trust. However, we do not see how the trustee could have "absolute discretion" if the trust forbids payments for all kinds of purposes (see the last bullet). The report should clarify what is meant by "absolute discretion."

- Page 12: The footnote on this page should be moved to the end of the sentence which says that States were allowed, for purposes of Medicaid, to penalize transfers of assets for less than fair market value. Also, the first sentence in the footnote should be revised as follows to more accurately reflect the law:

  > The Medicare Catastrophic Coverage Act (MCCA) repealed SSI's transfer rules, omitting any penalty for such transfers in the SSI program. However, SSI was required to notify SSI applicants and recipients about the transfer rules under the Medicaid program and to obtain information for Medicaid about any transfers. The MCCA also totally revised the Medicaid provisions on transfers of resources, making penalties for certain transfers mandatory and restricting transfer penalties to institutionalized individuals.

- Page 16: The last full paragraph says that Medicaid does not have the right to look on an after-the-fact basis at how trust funds were spent. This statement is not entirely accurate. A State Medicaid agency has the right to determine whether any of the trust funds were paid to or for the benefit of the applicant or recipient. Under SSI rules, these payments could count as income to the individual.

- Page 17: The last paragraph points out that under section 1902(a)(25), a State must have in effect laws under which, to the extent that payment has been made by Medicaid for an individual, the State is considered to have acquired the rights of such individual to payment by any other party in any case in which a third party has a legal liability to make payment for the assistance. Similarly, section 1912(a)(1) requires, as a condition of eligibility, that an individual be required to assign to the State any rights to payment for medical care from any third party.

The last paragraph goes on to say that since trusts are not "persons," or "parties," States may not have any success in going after them for payment. However, we believe that States must regard as the third party the defendant or other legally liable party in a settlement situation. That is, even if this third party settles with the injured individual by establishing a trust for his benefit, the third party still owes the State, which holds the rights to payment and is as yet unsatisfied. It is not clear to us why States should claim (see the top of page 18) that they are unable to use section 1912 to recover payments once they were made by third parties into trusts.

- Page 18: The fourth full paragraph on this page says that Congress restricted program eligibility in other similar instances and should consider doing so for these trusts. This paragraph should make it clear to what instances this refers and how or why they are comparable to the trust situation.

- Page 18: The last paragraph on this page contains OIG's recommendations to HCFA. The first suggests that the exceptions for disabled individuals be narrowed to exclude trusts set up with the proceeds of settlements with third parties. We believe that in many instances seriously disabled individuals will have settlements from third parties, and that the settlements will be in the form of a trust. Congress made no effort to exclude settlement situations and may have in fact been aware that individuals with large third-party settlements may be severely disabled and may need trusts to cover expensive lifelong needs above and beyond those covered by Medicaid. As such, HCFA may not want to recommend that Congress exclude settlements from the exceptions.

  We do believe, however, that the exceptions contain significant loopholes. The most prominent of these results from the fact that there are no limits on how trust funds can be used. Although the trust must provide a remainder interest to the State, there is nothing to prevent a trustee from "draining" a trust prior to the beneficiary's death. HCFA could recommend to Congress that it amend the exceptions to limit the use of trust funds to certain well-defined necessities (e.g., health care that is not covered by Medicaid). Once the disabled individual dies, a State could recoup its Medicaid costs from the remainder of the trust.

- Page 18: The last recommendation is that Congress strengthen Medicaid's right to recover from third-party settlors before settlements are placed in the trust or from the trusts themselves. We do not believe that this is necessary. That is, we believe that the Medicaid statute already provides a State with the right to recover payments from a liable third party and, in most situations, requires that a State do so.