

Trust Mills

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Introduction

One of the longest-running scams in California is the trust mill. It is, in short:

¥ a life insurance and annuity sales organization pretending to be a trust company or trust facilitator of some sort;

¥ offering free or low-cost living trusts, from their own form book, from a staff attorney or from a staff paralegal; and

¥ once getting a foot in the door, the salesperson proceeds to scare the daylights out of the prospect about going broke over the cost of long term nursing home care; then

¥ reveals the panacea —the single premium immediate or deferred annuity which is not counted in determining eligibility for long term care under Medi-Cal.

I had not thought of this scam in some time, comfortable with the effectiveness of the State Bar of California Truth Squad and prosecutions by the California Attorney General for practicing law without a license. A keynote presentation at the July 2002 meeting of the National Academy of Elder Law Attorneys, Northern California Chapter, however, brought it back to mind. Prescott Cole, staff attorney for California Advocates for Nursing Home Reform (CANHR), spoke to a different aspect of this problem: exposure of the scam artists to criminal prosecution. In these remarks, I draw heavily (and with his permission) on Prescott's thoughts.

Plug

If you happen to be investigating nursing homes for yourself or a loved one, go to the CANHR web site at www.nursinghomeguide.org. It has a massive amount of information on every long term care, assisted living and other forms of group home in California. You can filter and sort to your heart's content in order to focus on a particular kind of facility and a particular geographical area.

CANHR is a nonprofit, tax-exempt, organization fighting hard for quality care and fair treatment of the elderly and disabled. Founded by former social worker Patricia McGinnis, it has prosecuted lawsuits -- including class actions -- over the years to resist oppression from government and nursing home organizations. So, if you are budgeting donations for good causes, think CANHR, 1610 Bush Street, San Francisco, California 94109, telephone (415) 474-5171, facsimile (415) 474- 2904, e-mail CANHRmail@canhr.org, web site www.canhr.org.

Discussion

The concern addressed in this article is that trust mills and assorted bogus annuity sales schemes have continued to proliferate, notwithstanding strong institutional resistance from the bar associations, the attorney general and various senior citizens organizations. Their boilerplate trusts are not —and for cost reasons cannot be —tailored to the needs of the buyer, and the annuity is rarely suited to effective Medi-Cal eligibility planning.

The trusts, marketed through these trust mills seldom include such features as A-B provisions, authority for an agent under a durable power of attorney to amend the trust, unitrust income provisions to avoid the unhappy economic effects of the *Prudent Investor Act* on income beneficiaries, special needs trust provisions for beneficiaries who must rely on public social service programs like SSI or Medi-Cal, balancing arrangements to protect children from prior marriages, multi-generational provisions, etc. Most estate planning lawyers of my acquaintance agree that one out of five such trusts are so far off the mark that they constitute malpractice for any attorney the trust mill might have in the back room.

As to the annuities, the claim is that it is deemed unavailable, thus not counted in determining Medi-Cal eligibility. Therefore, by moving all the prospect's assets into an annuity, the annuitant may apply for long term care under Medi-Cal and the state will pick up the tab. Not always, and not effectively.

A few years ago, Washington issued *Transmittal 64* setting out the federal guidelines for deeming annuities unavailable for eligibility purposes. This publication included a set of annuity tables with shorter life expectancies than those of commercial issuers. It required not only that the annuities be paying annuity income *immediately* (not deferred and not interest withdrawals), but that they be based on the federal tables or some shorter period. Orders from Washington are read with interest by the states, but have no legal effect until adopted in some form *by* the states, one-by-one. In California, regulations adopting the federal guidelines were adopted, effective March 1, 1996, and the California Department of Health Services released a manual on the subject in April of that year. There is no dearth of information on annuity qualification, but the trust mills choose to ignore the legal requirements in order to dress up the product.

Example:

Mabel, age 88 and suffering from Parkinson's Disease, signs a trust mill product and purchases a single premium deferred annuity for \$100,000, substantially all she owns. She selects a long term care facility and checks in, then applies for long care benefits under Medi-Cal. 45 days later, the application is rejected because the annuity is available ... she has the right to surrender the contract for 90% of its value (\$100,000 less the trust mill's commission) and \$90,000 cash is too much. She calls an attorney unfamiliar with such matters, but who reads the state manual on annuities and corrects the situation by having Mabel instruct the

annuity issuer to begin paying the installments. Because the commercial annuity assumes a longer life expectancy than that required by the regulations, a shorter payout period must be selected. So, Mabel selects a five-year payout and reapplies. By this time, 60 days have passed at a cost for her care of \$9,000. This time, her application is approved retroactive to the date the second application was received, unless the attorney knew that retroactive coverage was available to the date Mabel *entered* the nursing home (maximum three months prior to the second application). But, her share of cost includes her \$900 monthly Social Security retirement benefit and the \$1,900 per month annuity installments, leaving the Medi-Cal program paying only the \$1,700 per month difference. Certain expenses are *not* paid by Medi-Cal (brand name medication, day trips, television, reading material, hair care, manicures, etc.) and only the Personal Needs Allowance deducted from her share of cost (\$35 per month) is available to defray those costs. At her death, the annuity continues for the balance of the payout period—to the state -- and nothing is left except the personal effects and other formerly exempt assets not originally swept into the annuity. Those assets lose their exempt status at death, so the state may take them as full or partial reimbursement of the benefits paid.

In the hands of a trained elder law attorney, Mabel could *instead* have employed any of several strategies by which to transfer assets (without loss of Medi-Cal eligibility) to children, other loved ones, a church or favored charity. Those donees might (voluntarily and without prearrangement) establish a trust for her benefit from the gift assets. That trust assets will not be counted in determining her Medi-Cal eligibility, yet they may be used to pay those expenses not covered by Medi-Cal (see above). This would add some small amount of comfort and dignity to an otherwise bleak time of life. As a benefit by serendipity, the trust estate reverts to the donee (children, loved ones, a church or favored charity) on Mabel's ultimate death.

If brought in after Mabel bought the annuity, the trained elder law attorney would probably make demand on the annuity issuer for a full refund. This would result in a commission charge-back to the trust mill. In doing so, the attorney would point out to the issuer the statements made by the sale person, comparing them to the correct information and leading to the conclusion that Mabel was the victim of a fraud.

Aside from common law fraud, Prescott suggests that trust mill operators may also be subject to *criminal* prosecution. He supports that notion with the following:

¥ *Penal Code* Section 532(a) provides:

Every person who knowingly and designedly, by any false or fraudulent

representation or pretense, defrauds any other person of money, labor, or property, whether real or personal, . . . , is punishable in the same manner and to the same extent as for larceny of the money or property so obtained.

He adds that there is no requirement that a *fiduciary* relationship (*e.g.*, spouse, trustee, attorney, dependency or confidentiality) exist between the thief and the victim.

¶ *Insurance Code* Section 785 provides that all insurers, brokers and agents owe an insured age 65 or older a duty of honesty, good faith and fair dealing. Administrative penalties for breach of these duties are \$250 for the first offense and \$1,000 to \$25,000 for each subsequent violation.

¶ *Insurance Code* Section 789.8 requires that extensive disclosures be made by life insurance agents selling life insurance and annuities to people over 65. Those disclosures include negative consequences of liquidating certain investments (life insurance, IRAs, securities, etc.) to buy the insurance product. The agent must also suggest that the prospect consult independent counsel or a financial planner prior to the purchase.

This section also imposes on the agent who bases the sale on Medi-Cal eligibility rules the requirement that the information given be accurate and complete.(although stated in the negative, ... may not negligently represent the treatment of any asset under the statutes and rules and regulations of the Medi-Cal program

It also requires that the agent, any time the sale is predicated on the annuity s utility in qualifying for Medi-Cal, provide a written disclosure describing the resource allowance, community spouse resource allowance, the availability of hearings before an administrative law judge and court orders by which to increase allowances, real and personal property exemptions.

¶ *Insurance Code* Section 790.03 defines as unfair and deceptive acts or practices in the business of insurance such as statements misrepresenting terms of a policy, misrepresenting the true nature of a policy or misrepresentations to induce a policyholder to surrender existing life insurance. This code section is long and detailed, providing in addition that untrue and deceptive or misleading statements about the business of insurance made to the public (*e.g.*, newspaper ads, direct mail, seminars, etc.) constitute unfair and deceptive acts or practices. Here are a few of Prescott s illustrations:

Free Information Seminar. Educational workshop about long term care and Medi-Cal planning. No products will be sold!

Since the whole purpose of the seminar is to sell annuities, the premise is false and may constitute a violation of *Penal Code* Section 532(a).

I m a certified advisor/Medi-Cal specialist!

If the presenter is an insurance agent. It is misleading to disguise this by pretending to be

a neutral, objective advocate. Since the intended objective is the sale of an annuity, these statements may be criminal *financial abuse* under *Penal Code* Section 532(a) and constitute the illegal *soliciting of business for an attorney* under *Business & Professions Code* Section 6125.

50% of all seniors will go into a nursing home. The average stay in a nursing home is 2_ years.

The statement is misleading. The California Department of Health Services reports that approximately 45% of all Californians will spend *some* time in a nursing home, and 71% are discharged within 90 days.

The purpose of this claim is to strike terror to the hearts of the listeners, in order to sell annuities. It may constitute criminal *financial abuse* under *Penal Code* Section 532(a), *theft* under *Penal Code* Section 484, *false pretenses* under *Penal Code* Section 532, violation of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 785 and an *unfair trade practice* under *Insurance Code* Section 790.03.

This is a free seminar. You pay no commission if you purchase an annuity here.

The listeners may not realize that the annuity rate includes a commission to the agent sponsoring the seminar. Those who fail to listen *critically* may also lack the skepticism necessary for their own protection.

It may constitute a *false pretense* under *Penal Code* Section 532, a violation of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 785 and an *unfair trade practice* under *Insurance Code* Section 790.03.

Lawyers are my competition. They will charge you thousands of dollars in fees for what I am telling you for free.

I sat through one complete presentation at a Kiwanis meeting. The misstatements of law and fact left me in respiratory distress. That aside, unless the agent is also a licensed attorney, every mention of state or federal law and how they affect assets, income and estate recovery means the agent is practicing law without a license. This is a violation of *Business & Professions Code* Section 6125.

I m working with an attorney, and she tells me that this is the law.

Smoke and mirrors. Same as above.

The annuity is the safest place to have your money. No one has ever lost money on an annuity. It is 100% guaranteed. It is exempt for Medi-Cal purposes.

The annuity is only as safe as the carrier issuing it. In the last decade or two, losses due to the insolvency of Mutual Benefit Life, Equitable Life of New York and Executive Life -- to name three -- run into the millions of dollars. Many others lose because they need the money before the forfeiture period (seven to ten years) expires. The Federal Deposit Insurance Corporation insures bank accounts, not insurance or annuities. An attractive rate of return is usually employed to induce people to buy, but the rate is typically guaranteed for no more than a year.

The purchaser may incur tax and surrender costs by liquidating other holdings in order to purchase the annuity. Uninformed or guileful agents may not inform the prospective purchaser that they need not liquidate exempt assets (IRA, home, etc.) in order to satisfy the need purportedly served by the annuity.

An annuity, to qualify as a deemed unavailable asset, must be in the payout mode at the time of application (not deferred and not on interest withdrawal), and the payout rate must distribute all principal (gross installment less the interest element) over the life expectancy shown in the federal tables. A *complying* annuity cannot have a period certain or refund feature. In practice, neither the Department of Health Services nor the counties have a clear fix on annuity compliance. As a result, non-complying annuities often slip by in the application process. The latest word from the Eligibility Branch of DHS, however, is that it is closing in on the problem, and no non-complying annuity will be grand-fathered in after the fact: not on hardship and not on any other ground.

Given the facts noted above, these claims may constitute violations of *Penal Code* Section 532(a), criminal *financial abuse of an elder* under *Penal Code* Section 484, *theft* under *Penal Code* Section 532, *false pretenses* under *Insurance Code* Section 785 and breach of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 790.03.

You must act quickly. If you want to protect your assets from being eaten up by a nursing home, you must move your assets 30 months before you apply for Medi-Cal. There are criminal penalties if you improperly transfer assets to qualify for Medi-Cal.

These are classic examples of statements literally true but misleading. First, this is an asset *purchase*, not an asset *transfer*. There is no penalty associated with the purchase of an exempt, deemed unavailable or counted resource before or during the 30-month look-back period, nor are there any criminal penalties. This is simply a pressure tactic intended to close the sale.

As such, these statements constitute false pretense violations under *Penal Code* Section 532(a), criminal *financial abuse of an elder*, under *Penal Code* Section 484, *theft* under *Penal Code* Section 532, *false pretenses* under *Insurance Code* Section 785 and breach of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 790.03.

The annuity is the best way to protect assets. You can move everything into an annuity and qualify for Medi-Cal.

In fact, the annuity is the device of *last* resort because almost all other options are superior to it. An *exempt* asset is one listed in the regulations as not counted in determining Medi-Cal eligibility. A *deemed unavailable* asset is one that cannot be reduced to cash at fair market value within a reasonable period of time. Only a *resource* (typically cash and securities) is counted in determining Medi-Cal eligibility. Assets in any of the three categories and in any amount may be given to the at-home spouse without loss of eligibility; and exempt and deemed unavailable assets may be given to *anyone* in any amount without loss of eligibility. Therefore, asset transfers may be planned around redeployment of resources into exempt and deemed unavailable categories to reduce or eliminate loss of eligibility altogether, *without* loss of the asset at death to either the annuity issuer or the state.

These half-truths constitute violations of *Penal Code* Section 532(a), criminal *financial abuse of an elder* under *Penal Code* Section 484, *theft* under *Penal Code* Section 532, *false pretenses* under *Insurance Code* Section 785 and breach of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 790.03.

A lot was said here today. If you are interested in having me go over these points again or learning more, I will be happy to arrange a time with you to do it. I can come over to your house. You will be under no obligation and I will not be coming over to sell you anything.

This is, of course, a ploy to get a second shot at those who do not purchase at the seminar site. As such, it constitutes a violation of *Penal Code* Section 532(a), criminal *financial abuse of an elder* under *Penal Code* Section 484, *theft* under *Penal Code* Section 532, *false pretenses* under *Insurance Code* Section 785 and breach of the *duty of honesty, good faith and fair dealing* under *Insurance Code* Section 790.03.

Conclusion

One way to protect California's seniors from these kinds of financial abuse is to encourage class actions against the abusers. If you see it, call me.