The Retirement Security Project

Policy Brief

Changing Medicaid and SSI Rules to Encourage Retirement Saving

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This policy brief is based on "Removing Barriers to Retirement Saving in Medicaid and Supplemental Security Income," Retirement Security Project, September 3, 2008, www.retirementsecurityproject.org, which contains a more extensive discussion of these issues.

Introduction

The vast majority of low-income American families either have no retirement savings at all or have saved just a small fraction of what they will need — on top of the Social Security and/or Supplemental Security Income (SSI) benefits they might receive — to avoid poverty in old age. For this reason, policymakers from both parties are expressing growing interest in increasing retirement saving by low-income households. If these families can accumulate some retirement savings to supplement their public benefits, fewer will be poor in retirement.

An important way policymakers can encourage low-income families to save for retirement is by removing the powerful savings *disincentives* posed by the asset rules in key means-tested benefit programs. Two programs are in particular need of reform: SSI, which provides subsistence cash aid to extremely low-income individuals who are elderly or have disabilities, and Medicaid, which provides health insurance to low-income children, parents, seniors, and people with disabilities (including most SSI recipients).

Medicaid and SSI Asset Rules Discourage Saving

To qualify for Medicaid or SSI, which many low-income people rely on at times during their working years, families and individuals generally must meet an asset test in addition to an income test. That is, their total countable assets must not exceed a dollar limit set by the program. In SSI, and in Medicaid for most recipients who are elderly or have disabilities, the asset limit is $2,000 for an individual and $3,000 for a couple. These limits are not indexed to inflation and tend to remain frozen for many years at a time. As a result, they have shrunk substantially in inflation-adjusted terms over the past several decades and are expected to continue shrinking in the future.

Moreover, both Medicaid and SSI count certain kinds of retirement savings toward these asset limits. In SSI, Individual Retirement Accounts (IRAs) and defined-contribution accounts like 401(k)s generally count toward the asset limit. (In contrast, payments from defined-benefit plans are counted as income, but the underlying savings are not counted as assets.) If an individual is eligible for periodic payments from a retirement account, he or she must apply for such payments in order to be eligible for SSI benefits.

In Medicaid, nearly all states have eliminated the asset test for children, and most states have eliminated the asset test for pregnant women as well. Most states continue to impose an asset test on parents with children, however, and most of these states count 401(k)s and IRAs toward the asset limit. Similarly, most states impose an asset test on individuals who are elderly or have disabilities, and these states generally count 401(k)s and IRAs toward the asset limit.

By counting retirement savings toward their restrictive asset limits, SSI and Medicaid rules discourage saving among parents who need health insurance through Medicaid, working-age individuals with disabilities, and poor seniors:

- **Families with children.** Often low-income working families need Medicaid temporarily during a recession and then leave the program once the economy recovers and jobs return. But if parents who have fallen on hard times had previously managed to accumulate modest retirement savings, they may have to deplete those savings - sometimes incurring a penalty for early withdrawals - to cover medical expenses if those savings place them over the state's Medicaid asset limit. Such families may be dissuaded from setting earnings aside in a retirement account again. They also may be more likely to need public assistance in their retirement.

- **People with disabilities.** SSI encourages people who have disabilities to work when possible by disregarding a portion of their earnings in the calculation of their SSI benefits. But SSI's asset rules discourage workers from taking advantage of an employer's defined-contribution retirement plan. Workers whose incomes are low enough to qualify for SSI cash benefits could lose those benefits if the modest savings in their retirement account place them over the SSI asset limit. Similarly, workers with disabilities whose incomes are too high to qualify for SSI cash benefits but who participate in a special SSI program that allows their Medicaid coverage to continue could lose Medicaid if their retirement savings place them over the SSI asset limit.

Even for individuals with disabilities who are working and *not* on SSI or Medicaid, the programs' treatment of retirement accounts may discourage them from participating in their employer's retirement plan while working, since doing so could jeopardize their future SSI and Medicaid eligibility if their medical condition worsens and forces them to stop working.

Moreover, under SSI rules, people who are eligible for periodic payments from their retirement accounts must apply for them, and the payments generally reduce their SSI benefits on a dollar-for-dollar basis. Many disabled SSI applicants of working age would qualify for periodic payments from their retirement accounts as a result of their disability, but if they took such payments, they often would deplete their savings before retiring.

- **Poor seniors.** Because of SSI's asset rules, individuals and couples whose low incomes and small assets qualify them for the program but who have modest retirement savings have several unappealing alternatives. They can forgo SSI, even if this means they must live in deep poverty, in order to retain their savings for major unforeseen expenses. Alternatively, they can consume their savings quickly and turn to SSI, which will provide them with a small monthly income and better health coverage but still leave them below the poverty line — and without a financial cushion in an emergency.

  A third option is to use their modest retirement savings to purchase a lifetime annuity, in which case the Social Security Administration (SSA) will not count these savings toward the asset limit. SSA will, however, reduce their SSI benefits on a dollar-for-dollar basis to offset their monthly annuity payment — and if that payment exceeds the maximum SSI benefit they would become ineligible for SSI (and in many states, for full Medicaid coverage as well). Moreover, a private lifetime annuity generally is not a wise investment for low-income individuals, given the high fees associated with them.

  Seniors who are eligible for periodic payments from their retirement accounts (either from defined-benefit plans or from small 401(k)s that are below the asset limit) face a different problem. They must apply for such payments in order to qualify for SSI, but the payments generally reduce their SSI benefits on a dollar-for-dollar basis. This means that poor individuals who have managed to save for retirement have no higher income in old age than they would if they had *not* saved.

What Changes Are Needed in Medicaid and SSI to Promote Retirement Saving?

This section outlines two proposed changes in Medicaid and SSI asset rules to encourage low-income individuals to save for retirement. The first, aimed at working-age adults, would remove the disincentives to save for retirement currently in Medicaid and SSI. The second, aimed at poor seniors who have accumulated modest retirement savings, would enable them to benefit from having saved.

Proposal 1: Encourage Non-Elderly Individuals to Save for Retirement

- *PROPOSAL: For non-institutionalized individuals under 65 years of age, exclude savings in qualified retirement accounts from the asset limits used to determine SSI and Medicaid eligibility and eliminate the requirement that such individuals apply for periodic payments from retirement accounts.*

Changing the SSI and Medicaid rules for low-income, working-age adults could reduce poverty among those individuals in old age, modestly reduce inequities in government subsidies for retirement savings, and establish more equitable treatment of different types of retirement saving within and across means-tested programs.

This proposal would enable parents who managed to accumulate modest retirement savings but have fallen on hard times to avoid the choice between forgoing needed health services and depleting their retirement savings to pay for that care before they can qualify for Medicaid. This would be particularly important for low-income working families that need Medicaid temporarily during a recession and will leave the program once the economy recovers.

This proposal would also allow people with serious disabilities who are able to work at times to set aside some of their earnings for retirement without jeopardizing their SSI eligibility (or their Medicaid eligibility, for individuals whose Medicaid eligibility is based on their receipt of SSI). For people with disabilities, Medicaid coverage can be extremely important.

To make the exclusion meaningful, the requirement that non-elderly individuals apply for periodic payments from their retirement accounts would need to be eliminated. Many SSI applicants of working age would qualify for such payments as a result of their disability, but taking the payments often would deplete applicants' savings before they retire. SSI applicants should be given the choice of whether to apply for periodic payments (which would be counted as income and reduce their monthly SSI benefits) or to retain their savings to draw upon in retirement.

Proposal 2: Eliminate Penalties on Seniors with Retirement Savings

Seniors who managed to set aside retirement savings while they were working should benefit from having saved. But they also should be expected to rely on their own savings to some extent, and should receive reduced SSI benefits accordingly. The proposal below, which consists of three related parts, would strike this balance. It is important to note that this proposal would *not* apply to people in long-term care and thus would not enable someone with substantial retirement savings to obtain Medicaid coverage for long-term care.

Part A: Exclude Retirement Savings Below a Certain Ceiling

- *PROPOSAL: For non-institutionalized individuals age 65 or older, exclude savings in qualified retirement accounts below a specified ceiling (indexed for inflation), such as $10,000 for an individual and $15,000 for a couple (or $15,000 for all households), when applying the asset tests used to determine SSI and Medicaid eligibility, and eliminate the requirement to apply for periodic payments from retirement accounts.*

Most SSI recipients have incomes well below the poverty line, even after their SSI benefits are counted. Data from the Census Bureau's Survey of Income and Program Participation indicate that fewer than 4 percent of individuals aged 65-69 with incomes below the poverty line have retirement savings that exceed $10,000. Those who have managed to accumulate modest retirement savings should be able to benefit from them, either to supplement their income or to cover one-time expenses that may unexpectedly arise, such as out-of-pocket medical expenses or essential home repairs.

The exclusion ceilings need not be the specific dollar figures suggested above, but they should be high enough to enable individuals to bring their monthly income closer to the poverty line or to cover some necessary one-time expenses. To minimize the number of applicants for whom SSA must obtain detailed asset information, the ceilings should also be significantly above the amount of retirement savings most SSI applicants have. The ceilings should be indexed to inflation so they do not erode over time.

In addition, the requirement that individuals must apply for periodic payments from their retirement accounts should be eliminated. SSI should allow seniors who are eligible to make withdrawals to decide when to make them and how much to withdraw, subject to the requirements of the tax laws. Some seniors may wish to live on a somewhat smaller income in order to have a cushion for unanticipated one-time costs (such as repairing a roof or home heating system), while others may choose to make monthly withdrawals to increase their income modestly above the SSI level.

Part B: Disregard a Portion of Withdrawals From Retirement Accounts

- *PROPOSAL: Reduce SSI benefits by $2 for every $3 in unearned income from qualified retirement accounts, rather than on a dollar-for-dollar basis.*

As noted, regular payments from retirement accounts (which SSA regards as unearned income) generally reduce an individual's SSI benefits on a dollar-for-dollar basis. In contrast, SSI disregards just 50 percent of earned income, so every $2 in *earned* income reduces SSI benefits by only $1.

Our proposal would treat seniors' payments from retirement savings more generously than other unearned income, but less favorably than earned income, by reducing SSI benefits by $2 for each $3 in such payments. This 33 percent disregard of withdrawals would be applied to payments from defined-benefits plans, payments from annuities, and withdrawals from a retirement savings account. Such a change would help ensure that people benefit from having saved for their retirement.

Part C: Treat Savings Above the Ceiling as an Asset or a Source of Annuitized Income

- *PROPOSAL: Treat savings in qualified retirement accounts in excess of the ceiling either as an asset that counts against the Medicaid and SSI asset limits or, alternatively, as the source of an assumed income stream based on the individual's age and the amount in the individual's retirement account at the time of application for Medicaid or SSI.*

Although the vast majority of low-income seniors have less than $10,000 or $15,000 in retirement savings, reforms to SSI's and Medicaid's asset rules must address how to treat retirement savings *above* this level.

One approach is to count any retirement savings above the exclusion ceiling toward the asset limit. This approach is simple for applicants to understand and for caseworkers to administer. A downside is that under this approach, if an applicant has retirement savings modestly over the excludable amount, he or she could lose eligibility for SSI and Medicaid entirely. This would create a disincentive to save more than the excludable amount. This approach could also encourage individuals to use their retirement account to purchase an annuity (which SSI and Medicaid would *not* count as an asset), even if an annuity is an unwise investment for a particular individual.

An alternative approach would be to treat any retirement savings above the exclusion ceiling *as though* they had been used to purchase a lifetime annuity. Specifically, SSI and Medicaid would exclude the “excess” retirement savings as an asset, but count an assumed (or imputed) monthly stream of payments from them as income that reduces SSI benefits. The assumed income stream would represent the amount, based on the individual's age and the amount of

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retirement savings above the ceiling, that could be drawn monthly from the retirement savings account over the course of the individual's remaining expected lifespan.

This latter approach raises significant policy design questions regarding how to avoid creating incentives to liquidate retirement savings rapidly and how to treat individuals in differing circumstances fairly. (For example, would the calculation of an individual's assumed income stream take his or her gender into account to reflect the different life expectancies of men and women?) For this reason, some may regard this approach as overly complex. On the other hand, once such design questions were addressed, this approach should not be too complicated to administer. SSI caseworkers would have a table on which they would simply look up the amount of the assumed monthly income stream, based on the applicant's age and amount of retirement savings.

Reforms Would Also Help Seniors Afford Prescription Drugs

Reforming SSI's treatment of retirement accounts would also enable many low-income seniors to qualify for help in paying for prescription drugs.

Medicare beneficiaries enrolled in the new Part D prescription drug coverage can receive subsidies to help offset the plan's premiums, deductibles, and co-payments if they are (a) also enrolled in Medicaid, (b) also receive SSI, or (c) have incomes no higher than 135 percent of the poverty line *and* no more than $10,000 in assets ($20,000 per couple). This asset test will disqualify about 2.4 million of the 14 million Medicare beneficiaries who do not receive Medicaid or SSI but whose incomes are low enough to qualify for the subsidies, according to a 2005 Kaiser Family Foundation study. These 2.4 million people “are disproportionately older widows who live alone,” the study found.

SSI rules are used to determine what types of assets count toward the asset test for the low-income drug subsidy. Therefore, changing those rules to eliminate penalties on seniors with retirement savings, as suggested here, would make more low-income seniors eligible for the subsidy to make their prescription drugs more affordable.

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