Continuing Care Retirement Communities
Can Provide Benefits,
but Not Without Some Risk:

The June 21, 2010 Government Accountability Office (GAO) study.

Summary. In reading the report an actuary is struck by a singular impression. That impression is created by what seems like a dawning awareness in the minds of the report's authors of the importance of the kind of analysis in which actuaries are skilled. The authors reveal a growing understanding of the uniquely intertwined mathematical and ethical complexities of the CCRC business. This mingling of the quantitative and the ethical finds its closest parallel in insurance. Although this insight remains merely implicit in the report, it is nevertheless the most profound finding offered.

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Draft Suggested Lifeline Article.

The U. S. Senate and the Government Accountability Office Look at CCRCs

On July 21, 2010, the Government Accountability Office (GAO) released a report titled, *"Older Americans: Continuing Care Retirement Communities Can Provide Benefits, but Not Without Some Risk."* The report was released to coincide with a U. S. Senate Hearing titled *"Continuing Care Retirement Communities: Secure Retirement or Risky Investment?"* The GAO report had been requested by the Senate Special Committee on Aging, which also conducted the hearing.

As is clear from the titles both the Senate and the GAO were striving for balance among contending views concerning the potential and current structure for the CCRC industry. The report and the panel balance the views of current regulators, CCRC residents, and providers. The GAO was simply asked to describe the current state of the industry and its regulation to reveal risks and how state laws address those risks.

Although the report is comprehensive, there are several things that are omitted and others that are only touched on tangentially. In preparing a review like this, it can be more valuable for readers, and for the authors of the report reviewed, to touch on those things that were overlooked, so that is what we have tried to do.

More attention could have been given, for instance, to the potential of the National Association of Insurance Commissioners (NAIC) model of insurance regulation which could be extended to the CCRC industry with salutary results. The report mentions the NAIC but does not elaborate on how its expertise overlaps with the oversight needs of the CCRC industry. The report, too, could have more clearly articulated the inherently actuarial underpinnings of the CCRC industry, though that understanding is implicitly present as an undercurrent running through the report and in remarks at the hearing.

The report is descriptive in accordance with the assigned mission. It doesn't purport to chart the way forward. That is left to others, the states, the providers, and the residents. In the report the providers are depicted as doing the best they can. The regulators are seen as doing what has been asked of them. The residents are seen as financially exposed, but that exposure has resulted in relatively few (in the eyes of the GAO) community failures that have harmed the residents. Although the residents may have been financially disadvantaged, the communities where they live have generally, with exceptions, survived allowing the residents to remain in occupancy.

The report and the panel discussion were silent on questions of financial equity among residents or between generations of residents. There seems to be little awareness among providers or regulators that there are issues of equity involved in the industry, so it's not surprising that the report itself is silent on those questions.

To clarify, if a CCRC underprices its offerings to the initial generation of residents, but increases its fees to make up the shortfall by charging later entrants more than the cost of their benefits, that can be seen as raising an equitable issue. The later group is required to subsidize the earlier group. Likewise, if residents entering at an older age are required to pay more to subsidize younger residents, that, too, raises an equitable issue. Questions like these were not discussed in the report or by the hearing panel.

Consistent with its neutral stance the report also treats as no more than options of personal preference the wide disparity in refund and care provisions among communities. Most residents seem to choose a community on the basis of location, quality, and amenities. Still, the choice of community carries with it implications about the financial commitments in the contract, and these provisions are largely decided by the provider and presented to prospective residents on a take-it-or-leave-it basis. The report does not comment on what contractual approaches might be optimal for those served by CCRCs nor does it elucidate how choice might be individualized, instead of being determined unilaterally by the provider.

The GAO study and the Senate hearing have brought CCRC risks to public light but have not offered solutions. Though the study was conducted at the Federal level, the consensus was that the response should come from the states. As the report concludes: "While GAO is not recommending specific action at this time, the potential risks to CCRC residents—as well as the potential for this industry to grow—highlight the importance of states being vigilant in their efforts to help ensure adequate consumer protections for residents." This is an effort in which NaCCRA can serve as a constructive catalyst.

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Review. The long anticipated GAO study of Continuing Care Retirement Communities (CCRCs) was completed on July 21, 2010 and released to the public in connection with the U. S. Senate hearing conducted by the Special Committee on Aging and titled "Continuing Care Retirement Communities (CCRCs): Secure Retirement or Risky Investment?" The GAO report and the Senate hearing are a matched pair. This discussion reviews the report with an eye toward what insight it offers for providers, regulators and residents.

The report itself is no more than a learning exercise to help inform the authors of the study and the Senators who would read it. The keyword repeated in the charge to the GAO was "describe" so the authors have done little more than to describe existing practice. It's hard to derive a constructive vision for what the CCRC industry could become merely from reading the report.

And the actual reading is tough slogging. The report tends to be superficial though that is all one should expect from investigators studying an industry for the first time. It is phrased in a way that sometimes obscures clarity of expression. For instance, the title itself involves the clever circumlocution, "... not without some risk." A clearer title might have been simply, "Risky Benefits," since that is how one might translate the GAO word choice into plain English.

Another alternative title is a term that emerged during the Senate hearing. That term is the simple Yiddish word, "Schande." "Schande" was used by both Al Franken and Chairman Kohl in summation of their feelings after listening to the testimony at the July 21, 2010 hearing. It's close to our word "scandal" and it implies a deceptive betrayal of trust, a disgrace.

The report itself follows the obscurity of the title. The report does not tend toward clear conclusions, but instead reads like an undergraduate paper in which a student recounts the effort that has gone into his or her research. It is clearly less than a thoughtful, reflective review of the industry but then it was only intended to be descriptive. Despite the seeming safe neutrality of the reports phrasing, reading between the lines reveals that all is not well in the CCRC industry, and the spontaneous evocation of "Schande" shows how pressing is the need for bold thinking and constructive change.

The tone of the report is that of the social sciences. There is a tendency in the social sciences to play it safe... to let statistics and attributions convey the message... to defer to experts... to avoid hyperbole, in a kind of self-effacing diffidence in which omission averts criticism and advocacy is left to others. These elements are all present in the GAO report, but an astute reader can deduce the underlying message from between the lines and form conclusions that are consistent with the evidence and reflective of the current state of the industry.

People who are close to the industry can discern the interview sources for many of the reports statements simply from an awareness of whom among the group that the report terms

“industry participants” holds the particular opinions cited despite the lack of specific attribution in the report. The research appears to have been limited to organizations [corporate entities], e.g. providers, regulators, industry and resident associations, etc., rather than probing for individual thinking or unbiased analysis beyond these established institutions. Since organizational leaders sometimes put the interests of the organization above those of the constituent members, there are limitations to this approach though it was the organizing principle for society during the Middle Ages. It persists today in the tension between trade unions and employers where the collective interest is paramount.

The report and the testimony seem to think positively of the potential for CCRCs to meet the aspirations of residents. In brief, that aspiration is often expressed as a wish on the part of the resident to be able to provide for the contingencies of aging without having to be a burden on one’s children, or on others, or on government programs like Medicaid or welfare. The providers’ concern is for the financial survival of the enterprise to meet the good intentions of the organizers and founders.

These somewhat convergent, but largely divergent aims, are touched on in the report and testimony but only implicitly. One has to read between the lines, for example, to sense the authors’ growing awareness that actuarial analysis, rather than accounting ratios, provides the key to the sound fiscal management of CCRCs and their ethical obligation to respond responsibly to the trust placed in CCRC managements by residents who turn over their life savings in the form of entrance fees, which are only partially refundable and then subject to conditions. Residents enter into this relationship of trust expecting that the provider’s representations, both implicit and contractually explicit, will be fulfilled or exceeded.

Unlike cash flow measures that emphasize current viability, or escrow arrangements that elevate some CCRC obligations such as refunds above others such as end-of-life care commitments, actuarial analysis gives equal weight to all contractual commitments. Actuaries have been largely sidelined to a minor role in the industry. It is an implicit conclusion of the GAO report that this containment of actuarial input has been unfortunate for the CCRC industry. In fact, this may be the most telling – though unarticulated – conclusion of the GAO study.

Here is a summary of some of the conclusions that can be deduced from the report, aside from the hidden conclusion that greater involvement of actuaries in CCRCs from conception through fulfillment could help address the issues raised when CCRCs make lifetime commitments but are only viable for a limited future period.

The core conclusion is stated as, “While GAO is not recommending specific action at this time, the potential risks to CCRC residents – as well as the potential for this industry to grow –

highlight the importance of states being vigilant in their efforts to help ensure adequate consumer protections for residents." It seems evident that this conclusion is politically constructed. Deconstructing it leads to embedded conclusions that:

- Consumer protections for residents are now inadequate;
- CCRC residence is risky for residents;
- The industry has growth potential; and
- The states have the primary regulatory responsibility.

Other embedded conclusions can similarly be deduced from other sections of the report. Primary among them is the inference that the National Association of Insurance Commissioners (NAIC) can take the leadership role in improving state regulation, i.e. helping the states to be "vigilant in their efforts to help ensure adequate consumer protections for residents." Implicit in this statement is the view that state regulation should give a higher priority to resident protections than to assisting the growth of the industry.

Page 34 of the report notes that a draft of report was provided to the NAIC as well as to the Department of Health and Human Services (HHS), the Federal Department most involved because of its responsibility for Medicare and Medicaid and the nascent Community Living Assistance Services and Support (CLASS) Act. The NAIC provides to state regulators expertise (including actuarial expertise) that many states lack. It also provides a deliberative process (and forum) that has brought intelligent and effective regulation to the insurance industry. Inclusion of the CCRC industry within the NAIC system was suggested during the July 21, 2010 U.S. Senate hearing.

A secondary embedded conclusion is the desirability of elevating the initiating and management leadership for the CCRC industry to embrace more sophisticated talents for ensuring financial soundness and for regulatory interactions. This conclusion is implied by statements like that appearing as early in the report as its third sentence, viz., "Developing CCRCs can be a lengthy, complex process that requires significant long-term financing and accurate revenue and cost projections." The process may be lengthy but it need only be complex for the unversed. As far as I know there are no actuaries working for CCRC providers.

A tertiary conclusion is that "CCRCs can benefit older Americans," though the report then quickly segues to conventionality when it attributes this benefit to CCRCs' segmented residential components, "allowing [residents] to move among and through independent living, assisted living and skilled nursing care in one community." It's true that these three gradations of response tend to be discrete elements within a CCRC but, increasingly, care responsiveness is

blending across what is now seen as a continuum of care. The discrete segregation into independent living, assisted living and skilled nursing reflects a provider perspective emanating from what is needed for licensure and reimbursement rather than reflecting the needs of older Americans as they age and decline.

The CCRC industry is the only industry that has the potential to serve the full continuum of needs for aging Americans from active living through demise. It is also the only industry that allows active, healthy people to take full responsibility for the costs and care that they can anticipate needing as they age. There is a growing climate of opinion looking to the public treasury for these needs. The CCRC industry offers an alternative of individual responsibility and should be encouraged. Unfortunately, the report is silent on this aspect of the CCRC industry.

The current public policy calls for people to "age in place," meaning that they are to be encouraged and supported in the popular wish to stay in their own homes for the rest of their lives. The dispersed nature of this commitment is expensive and the outcome can be deleterious for the aging population. Serving people in homes that are spread throughout a city or region is inherently more costly and less effective than serving them in a residential community like a CCRC. Not only is the quality of service improved and the cost reduced, but the residents benefit from the social interaction of living in a close-knit community among their age-related peers.

Imagine the life of an elderly widow, who is now losing her vision to macular degeneration, unable to read, unable to fully enjoy television, unable to dial a telephone, with no outreach and with no human contact other than the occasional visit, if she's lucky, by a volunteer messenger from meals on wheels. She sits sadly, forlorn, in her recliner; perhaps, that's where she sleeps as well. Unattended, unwanted, forgotten. That is the sad reality for many Americans.

I find it particularly unfortunate that the report gave no emphasis to this socially positive, resident empowering aspect of the CCRC promise. Instead, there was a implicit impression that CCRCs are care centers, with people starting out in nominally independent living and advancing through mounting stages of care till life's end. There is a need to reexamine the 1965 Congressional adoption of aging-at-home as the aim of public policy. The GAO report offered an opportunity to address that imaginatively and positively. It did not.

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Explicit findings. Delving more deeply into the report reveals missed opportunities. By seeking to play it safe and to avoid ruffling the feathers of any interest group that might have been impacted, the report has missed opportunities to advance the welfare of seniors.

To put this in context let's look at a summary of conclusions deduced from a superficial reading of the report.

1. The CCRC concept is positive and promises desirable benefits for seniors.

2. Developing CCRCs can be a lengthy and complex process.

3. "Once operational, risks to long term viability include declining occupancy and unexpected cost increases."

4. States vary in the rigor and vigor of regulation. "The lack of a long-term focus creates a potential mismatch with residents' concerns over their CCRCs' long-term viability."

5. "Regulators and CCRC providers GAO spoke with generally believed that current regulations were adequate, but some consumer groups felt more comprehensive oversight was needed."

6. Though rare ... "should a CCRC failure occur, it could cause residents to lose all or part of their entrance fee."

7. "Residents can also become dissatisfied if... there is a change in arrangements thought to be contractually guaranteed, such as charging residents for services that were previously free."

Next, a recounting of some of the risks faced by CCRC residents includes:

1. Financial difficulties can lead to unexpected increases in monthly fees

2. Residents can lose all or part of their entrance fees if there is a financial collapse.

3. CCRC policies and operations may fall short of residents' expectations.

4. CCRC managers may unilaterally begin to charge for services that were previously included or that were thought to be covered by the contract.

The report discusses regulatory measures that might address some of the issues uncovered.

1. Some states require escrow of entrance fees. Escrow here is defined as "... a deed, a bond, money, or piece of property held in trust by a third party to be turned over to the grantee only upon fulfillment of a condition." The report is silent on the ramifications of a requirement like this, not all of which are positive either for residents or for providers.

2. “A number [of states] require contracts to be readable, but not all review the content of contracts even though some industry participants questioned residents’ ability to fully understand them.”

3. “Not all [states] require disclosure of policies likely to have a significant impact on residents’ satisfaction, such as policies for moving between levels of care.”

4. “According to an industry study, 12 states do not have CCRC-specific regulations, meaning an entity in 1 state may be subject to such regulations while a similar entity in another state may not, and consumers in some states may not receive the same protections as those in others.”

5. “Some CCRCs voluntarily exceed disclosures and protections required by state regulations.”

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Detailed Review of Report. Looking at details of the report gives the following reflection.

p.5. The discussion of contract types shows no understanding that the extensiveness of contract coverage, denoted according to an AAHSA developed scale as Type A through Type D, does not have to be determined at the community level but could be reinsured, freeing providers from all risk and allowing individual arrangements to meet the individual needs of individual residents.

p. 6. “According to CCRC providers, prospective residents are generally screened to determine their general health status in order to determine the best living situation.” No description is provided of what standards are used, how they are applied, and whether they are consistent among communities.

p. 6. “Prospective residents must also submit detailed financial information that includes income and tax records to ensure that they can pay CCRC fees over time.” Likewise, there is no description of the standards and whether they are equitably applied among residents or between communities. The implication is that there is a wealth test for admittance.

p. 6. There is implicit recognition that many of the industry’s difficulties could be averted with greater actuarial involvement. “For example, one CCRC we reviewed uses actuarial studies with mortality and morbidity tables to assess the likely inflow, outflow, and turnover of the CCRC occupants.”

p. 8. The need for actuarial analyses as the basis for a sound CCRC industry is again implicit in the statement near the bottom of the page: "Determining appropriate fees can, in itself, be a complex process because it involves projecting a number of variables into the future, including occupancy levels, mortality rates, medical and labor costs, and capital improvement costs. For this reason, many CCRCs use actuarial consultants to help in these determinations." It's surprising that all CCRCs don't use such projections to ensure that they will be able to meet the commitments that they make. This raises the question whether the industry has developed a sufficient number of executives with the judgment and skill set needed for the sound operation of the communities.

p. 8. At the bottom of the page there is a discussion of the complexity of fee determination. The actuarial analysis referenced can allow managements to decide in advance whether the market will support fees that are sufficient to cover the commitments made. The balance is described as, "CCRCs generally have to keep prices low enough to attract residents and stay competitive but high enough to meet short- and long-term costs." Since the commitments are for the lifetimes of the residents and beyond, the skills of actuaries versed in the contingencies of human existence are needed.

p. 9. One of the major risks for residents in nonprofit communities is mentioned here, namely, the potential loss of the tax exemption associated with nonprofit status. Here the report notes "...many nonprofit CCRCs rely on property tax exemptions when estimating CCRC costs and developing CCRC projects. According to industry associations and a state regulator, however, difficult economic times are causing some municipalities to look for new sources of revenue, and some may be reevaluating property tax exemptions previously granted to CCRCs. Loss of these exemptions can be very costly;..."

It's not clear if the authors of the report were conversant with the Internal Revenue Service positions concerning CCRCs, in particular Revenue Ruling 72-124, which concludes "Providing for the special needs of the aged has long been recognized as a charitable purpose for Federal tax purposes where the requisite elements of relief of distress and community benefit have been found to be present." After discussion, the ruling continues, "However, it is now generally recognized that the aged, apart from considerations of financial distress alone, are also, as a class, highly susceptible to other forms of distress in the sense that they have special needs because of their advanced years. For example, it is recognized in the Congressional declaration of objectives, Older Americans Act of 1965, Public Law 89-73, 89th Congress, 42 U.S.C. 3001, that such needs include suitable housing, physical and mental health care, civic, cultural, and recreational activities, and an overall environment conducive to dignity and independence, all specially designed to meet the needs of the aged."

It is this 1972 change of direction by the tax authorities that today's CCRCs rely on for their tax exemption. The ruling then concludes, "Thus, an organization, otherwise qualified for charitable status under section 501(c)(3) of the Code, which devotes its resources to the operation of a home for the aged will qualify for charitable status for purposes of Federal tax law if it operates in a manner designed to satisfy the three primary needs of aged persons. These are the need for housing, the need for health care, and the need for financial security." This is the thin thread from which the nonprofits' tax exemption hangs. Hence, the risk of loss of tax exempt status is an ever present danger.

p. 10. Referring to contractual commitments that residents may receive partial or complete refund of entrance fees, the report states, "These refunds represent substantial financial obligations that CCRCs must meet and can significantly affect operations because fees are used to maintain a certain level of liquidity, or cash on hand. CCRC officials said that refunds were usually contingent on having a new resident move into the vacated unit and that a recent reduction in occupancy levels has meant former residents and their families have had to wait longer for refunds." Thus, there is no assurance that a resident who needs to move will be able to finance a replacement home.

Moreover, many communities' contracts have entrance fee refund provisions that go to zero after five or six years, meaning that the CCRC retains the full entrance fee when the resident dies or leaves. If a person has to leave, or the community fails as Pacific Homes did some years back, then the absence of any refund can leave that person destitute and with nowhere to turn except to become a ward of the state. The no refund arrangement can mean that a resident's life savings are lost, leaving the resident with nothing and no option that preserves individual dignity and responsibility. Because of this, some people believe that a provider with such a sharply graded refund provision takes on a higher moral obligation to be sure that the commitments made to the residents will be met throughout their entire lives, even in the event of financial collapse.

p. 10. The analysis of the Erickson Retirement Communities bankruptcy and reorganization in the bordered box only quotes Erickson officials as its source and provides no independent critical review of the Erickson failure.

p. 10. The report refers to economic risk, which it terms "external economic factors that are out of [CCRC manager's] control." Prudent managers anticipate economic exposures and make allowance so the conclusion that external factors are beyond control is only partially valid. Such risks can, and should be foreseen.

The report is silent on other exogenous risk exposures, including such risks as the risk of governmental intervention that can impose fiats on the organization that may be contrary to commonsense and prudence, or the risk of unionization which can increase costs by impeding steps to improve productivity or to meet "soft" objectives. Managers need to allow margins so that unpredictable risks like this can be anticipated and met from accumulated resources.

p. 11. The report provides no documentation for the statement, "One rating firm, which produces an annual industry outlook for CCRCs, said the outlook for CCRCs in 2009 and into 2010 is negative because of their declining liquidity and other financial ratios, tightening financial markets, and difficult real estate markets. The firm also noted, however, that the negative effect of the slow real estate market and falling occupancy levels could be softened somewhat by some favorable factors, including strong demand for entrance into CCRCs, effective management practices, and favorable labor costs." This statement of mere opinion is only as valid as its source, and without any attribution, there is the risk that it will be given greater credence merely because of its inclusion in a GAO report.

p. 11. The report discusses regulatory requirements for feasibility studies and notes the variability in requirements from state to state. Feasibility studies are an essential part of any business planning process, and more so for a long term undertaking to provide sustenance for vulnerable, aging seniors. Generally, the providers of capital insist on well-reasoned business planning, though this insistence is diluted when there is an offering to the public.

Securities laws – both at the state and Federal levels – have long recognized that the public offerings need oversight to ensure that there is substance to the investment. Public investors are dispersed and represented only by the underwriting investment banker. Public investors do not have the same authority as do concentrated private investors to demand prudent advance planning and reasonable oversight for management deployment of invested funds.

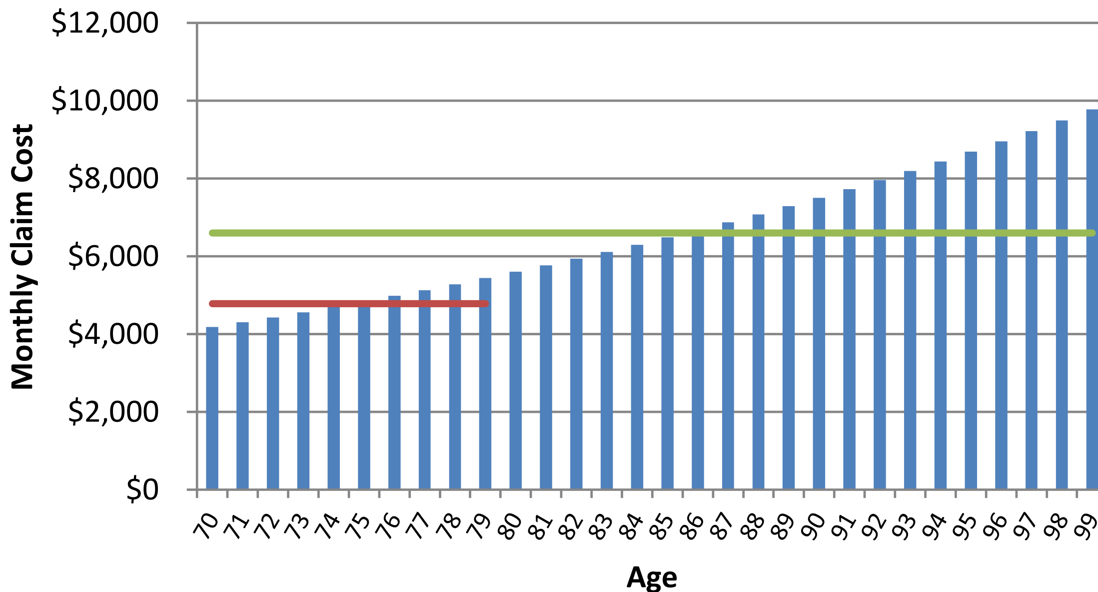
The investment by residents of entrance fees constitutes a form of public investment that should, perhaps, be subject to the same blue sky and investment security disclosure requirements as are other "at risk" investments. The GAO study is silent on this possibility. There is a public policy interest in ensuring that projects like CCRCs involving the payment of large initial investments in the expectation of long term returns are well thought through and are not deceptive.

p. 12 Toward the bottom one finds the following discussion of actuarial studies: “In particular, California, New York, and Texas required periodic actuarial studies, but only for CCRCs that offered contracts which incur long-term liabilities by guaranteeing health care services over the long term. One state we reviewed—Florida—did not require periodic actuarial studies but did analyze financial trend and projection data to help track the direction of the financial condition of CCRCs over time. Florida regulators said that they maintained a spreadsheet containing financial information on CCRCs dating back over a decade and used the data to develop financial trend information on each CCRC, including trends of ratios related to CCRCs’ revenues and expenses. Florida officials said that since CCRCs generally do not go from stable 1 year to financially distressed the next, their trend data enabled them to identify early on CCRCs that might be in trouble.”

This data collection and analysis process describes a regulatory tracking concept that was devised by Robert Callahan, who was an actuary in the New York State Insurance Department, to allow regulators to identify early variations in financial trend patterns that could be indicative of operating shifts that might portend trouble. Aberrations in trends do not, in themselves, constitute evidence of problems but they can guide regulators to make inquiries that can facilitate early intervention to prevent problems from escalating. Delay can be fatal in financial matters since mounting deficits, if unaddressed, can rapidly snowball to become difficult to reverse, leading inexorably toward failure.

p. 13 The case is made here for more actuarial engagement in CCRC financial management with attribution to “industry participants.” Again the report is merely descriptive, in keeping with the GAO charge, and does not critique what it found. “In addition, some noted that actuarial studies can help regulators identify potential threats to CCRCs’ long-term viability. For example, New York officials noted that requiring an actuarial study from CCRCs every 3 years provided 10-year cash flow projections and CCRC information on actuarial assets and liabilities that were critical to understanding long-term viability.“ The inference here is somewhat troubling, implying that a 10 year projection is sufficient to cover lifetime commitments.

Using claim costs approximately derived from the Federal Employees Long Term Care Insurance program shows escalating costs of care like those below. Since these numbers are derived from an insured program they include a constant administrative expense load, so the slope of net claims cost, such as those incurred under a Type A CCRC contract, are likely steeper.



It is evident that a ten year projection for a new resident 70 years old does not make adequate allowance for the escalation in costs that can be expected as the resident ages. The red line shows the average cost over the first ten years while the green line shows the average cost to age 100. Funding at red line levels will leave a shortfall later.

p. 13 The discussion of reserves, in the last paragraph on the page, is particularly illuminating. The paragraph opens, "To help ensure that CCRCs have funds available to pay for expenses such as debt service and operations, most of the states we reviewed also required CCRC providers to maintain some minimum level of financial reserves." This reflects a core proposition running through the report that the overriding aim of management and regulation is financial survival rather than contract fulfillment.

Most actuaries use the concept of "reserves" in a different sense. Actuaries consider reserves to be the quantification of the funds needed to be on hand to allow a contracting entity to meet its probable contingent commitments toward those with whom it has contracted. Let me rephrase this, since it's so important to the sound operation of a CCRC. Reserves, in an actuarial sense, are those funds, which together with anticipated, reasonable future income streams, will suffice to allow an organization to meet its contractual and other commitments. This is just commonsense for saying that funds on hand plus future income has to be enough to pay all the CCRC costs. Actuaries use the term "reserve" to denote those needed "funds on hand."

The GAO report confines the need for reserves, i.e. for setting aside funds for high priority purposes, solely to "debt service and operations" in that order. While it's true that most failing CCRCs are called to account by the debt holders when the CCRC is no longer able to comply with the bond covenants, that circumstance does not address the vulnerability of the residents to diversion of their entrusted life savings which will have been exhausted before the debt holders are impacted.

The actuarial view is a more comprehensive one that takes into account all obligations of the entity over the full term for which those obligations have been undertaken.

p. 13 bottom: The report records reserve requirements for various states contacted by the GAO. None of these requirements is similar to the reserving required of insurance companies by the Standard Valuation Law, which law accords more with the more comprehensive actuarial view articulated above. The report states: "According to state regulators, the primary purpose of reserve requirements is to ensure enough time for a financially distressed CCRC to reorganize or restructure financing while keeping the CCRC operational for its residents." This standard of regulation overlooks the possibility of ensuring sound operation in the first place and, more importantly, it is silent on the equitable interests of the residents and the need to shield them from imprudent diversion of their payments to inefficient operations or excessive staffing or compensation levels.

Ironically, the Internal Revenue Service (IRS) has articulated this regulatory interest in its dictum that nonprofit CCRCs operate "at the lowest feasible cost" when the Service states in Revenue Ruling 72-124: "As to the second condition respecting the provision of financial security, the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization. In case of doubt as to whether the organization is operating at the lowest feasible cost, the fact that an organization makes some part of its facilities available at rates below its customary charges for such facilities to persons of more limited means than its regular residents will constitute additional evidence that the organization is attempting to satisfy the need for financial security, provided the organization fulfills the first condition regarding the provision of financial security."

My sense is that the IRS is using the term "reserves" here more in the comprehensive actuarial sense than in the narrow sense in which the term is generally viewed among CCRC providers.

p. 13 The report details its findings concerning reserves in the states the GAO studied. "Reserve requirements in the states we reviewed were typically expressed in terms of total debt service payments for a time period ranging from 6 months in Illinois to 1 year in states such as California, Florida, New York, Pennsylvania, and Texas. Some states also required a reserve for operating costs that ranged from 2-½ months to 1 year." This is referring to a standard that is more protective of the debt holders than of the residents.

p. 13 The report continues, "New York, by comparison, required debt service and operating cost reserves along with an additional reserve for CCRC facility repairs and replacement. One state—Wisconsin—did not have reserve requirements. Wisconsin state officials said that their statutory authority generally focused on the content of CCRC resident contracts. While these reserve requirements can provide a CCRC with enough time to work to improve financial conditions, several industry participants said that reserves are not intended to ensure viability over the long term."

The residents are expected to contract for their lifetimes, i.e. for the long term, so it is a stunning admission here by the GAO that there is no comparable requirement that providers be required to respond constructively to that resident commitment. Residents commit their life savings to the CCRC in anticipation that they will be secure for their remaining lifetimes; the providers don't seem to have a similarly long term financial planning horizon.

My view is that the GAO has unearthed a major disconnect here between what residents are expected to do and the requirements for providers. Unfortunately, the GAO glosses over this disconnect, simply touching on it as something to be reported, but without seeming to allow the obvious imbalance to impact the report's conclusions. The report does state in passing, however, "Without actuarial studies, [industry participants] said, a CCRC may appear financially stable in the short term yet still face threats to its long-term viability." This is a stunning and disturbing statement.

p. 16 includes an intriguing footnote showing that the GAO authors are fully conversant with the National Association of Insurance Commissioners' (NAIC) regulatory model, though they have not directly applied it within the CCRC context. During the Senate Hearing on July 21, however, at least one speaker pointed to the NAIC as a way out of the weak regulatory mélange that led to the use of "Schande" in response to various developments, and potential developments, that might adversely impact CCRC residents.

p. 18 makes clear the primacy of debt holders and the investment bankers who serve them in the shaping of the financial consciousness of the industry. The interests of these debt

holders are evidently primary in the thinking of both provider executives and state regulators as evidenced by the report's statement: "...state regulators and industry participants said states and lenders require CCRCs to maintain levels of reserves that are intended to give the facilities enough time to meet financial challenges such as refinancing or restructuring debt."

p. 18 in the last paragraph makes reference to the voluntary accreditation offered by the Continuing Care Accreditation Commission (CCAC). This is a form of independent, voluntary regulation of which just 16% of industry providers avail themselves, according to a statistic cited during the July 21, 2010 Senate Hearing. With such a low participation rate it is evident that the industry is not open to embracing voluntary regulation and that state oversight is required.

Some providers have opted to institute their own "quality assurance" programs in which staff executives and consultants evaluate the performance of other executives working for the same provider. Obviously, such programs lack independence and are unlikely to offer any credible level of objectivity or imagination in their evaluations.

CCAC financial standards have in the past been more accounting derived than actuarial, and so they have hewed more toward solvency from a financier's perspective, than from the perspective of a resident concerned for fulfillment of promised commitments, but CCAC is in the process of reviewing its approach; it's standards are under constant review and refinement; and it is currently the best analytical resource available for prospective residents to use to compare alternative CCRCs.

p. 19 top: The statement at the top of the page, "While accreditation standards do not require periodic actuarial studies, according to CCAC officials CCRCs are expected to use actuarial and other information to appropriately set their fees," provides promise that CCAC may lead the way in guiding the CCRC industry toward a standard that is more protective of the residents who are the evident beneficiaries of the nonprofit sector's charitable purpose and the customers for the for-profit sector.

p. 19 in the second paragraph, the report cites a highly questionable premise, namely: "Some [state regulators] suggested that the small number of CCRCs that were financially distressed, insolvent, or had filed for bankruptcy pointed to the adequacy of state regulatory oversight." This is a *post hoc ergo propter hoc* argument for the status quo and that is a logical fallacy that has been repeatedly refuted since ancient times, when the falsity of this kind of argument as valid was first revealed (hence, the Latin term used to describe it).

The fact that few CCRCs have failed does not mean that there won't be future failures. Moreover, just because a CCRC hasn't failed does not mean that the residents have not been financially disadvantaged by unsound operating practices that may have driven up costs and reduced services for the residents. The GAO report is entirely silent concerning equitable treatment of like-situated classes of residents.

In his talk to Fox Business News on August 13, 2010, Larry Minnix, President and CEO of the American Association of Homes and Services for the Aging (AAHSA), said that the default rate on CCRC indebtedness has "only" been 6%. If 6% have defaulted, it's likely that a larger percentage were financially strained but balanced their books by increasing resident fees, or reducing resident services, beyond what was anticipated in the original planning or in the marketing materials used to induce the charter class of residents to move in.

p. 19 bottom. The regulatory aims implicit in the discussion suggest that mere facility survival is a sufficient regulatory purpose. This is a low standard which ignores fulfillment of contractual commitments, implicit and explicit, made by providers to induce residents to move in.

p. 20. The dearth of actuarial involvement in the oversight of the CCRC industry is touched on here. "One CCRC provider said that the extent and effectiveness of regulators' financial oversight of CCRCs varied from state to state but noted that for oversight to be effective, states would need specific expertise. The provider also felt that state agencies that had devoted few resources to CCRC oversight might lack the requisite expertise." Presumably the principal expertise that is lacking is actuarial.

The report continues, "By contrast, actuaries GAO spoke with said that, overall, only a few states nationwide were appropriately using actuarial studies to assess CCRC providers and that many states were using very little actuarial information for financial oversight. Actuaries said this situation reflected the wide variety of state laws and regulations on CCRCs and noted that states that did not require actuarial studies could have a difficult time assessing the adequacy of CCRCs' short- and long-term pricing structures and long-term financial position."

Actuaries have been largely sidelined by the industry, with some providers arguing that the needed actuarial expertise is too expensive and should, therefore, be foregone, which seems like a disingenuous rationalization; others seem fearful that their own inexpertise may become manifest if the quantitative expertise of actuaries were more widely deployed.

p. 20 The risk alluded to at the bottom of the page, viz. the risk that "residents could lose the refundable portion of their entrance fees—which may amount to hundreds of thousand of dollars or more—if a CCRC encountered financial difficulties," rises to the certainty of loss for those providers who don't offer an equitably priced refund contract option. These providers require that residents accept the full loss of their entrance fees after a period of four to six years or pay such an exorbitant surcharge for the refund option that few residents choose the option.

This loss of entrance fees can wipe out the full life savings of such residents, leaving them destitute except for the promises of the provider, which may prove to be hollow promises if the provider has not adequately projected the resources needed to provide the promised lifetime care. There is also the accompanying risk that, even where there is a refund provision, the provider may unilaterally withhold the promised refund, for as much as ten years in California, if the provider fails to refill the vacated apartment even though the sales process is solely under the control of the provider.

p. 20 Very bottom, referring to resident losses, the report seems to minimize resident financial vulnerability by concluding: "We identified no national data that would reflect the incidence of such losses, and several state officials believed that they are rare," as though rarity of occurrence made such loss any less devastating for those who lose all of the life savings which they entrusted to the stewardship of an organization ostensibly committed to their lifetime care.

p. 21 at the bottom seems to show lack of awareness of the Revenue Ruling 72-124 requirement that residents be sustained in occupancy when their assets run out, unless the GAO was thinking solely of for-profit operators and that seems unlikely. The sentence reads: "According to CCRC operators, residents are not generally at risk of being required to leave a CCRC when they exhaust their assets but instead use the refundable portion of their entrance fee, if there is one, to cover monthly costs. When these funds are gone, the CCRC uses charitable funds, voluntarily contributed by other CCRC residents, to support the residents."

p. 22 addresses transfer trauma as it afflicts the elderly. This is a delicate question since sometimes elderly persons must be transferred for their own benefit to be sure that they can receive the care that they need. But people who are afflicted, say, with Alzheimer's disease may become frantic if they are taken away from all that is familiar to them, including their loved one or ones, and the impact can be devastating, leading to decline or worse.

The most attractive aspect of the CCRC concept is the support that is available for people to minimize such traumatic transfers and to stay near home or in home as their condition changes. Transfers may be necessary because a facility does not have a required license – this is something that providers can avoid by becoming as fully licensed as possible. Some transfers are needed, for example, when a resident requires a procedure that can only be legally performed in a hospital. Thus, transfers are unavoidable though the recent initiative to develop Accountable Care Organizations (ACO) may mitigate this somewhat.

There is a high level of stewardship responsibility inherent in the necessary power given to CCRC administrators (and adult protective services for the general community) to require such transfers when that is best for the resident and to accomplish the transfer with as little trauma as possible. This responsibility is compounded by the fragility and loss of comprehension that is often manifest in those most needy of specialized care.

Transfers should never be initiated solely to free CCRC units so that they can be resold for an entrance fee to boost cash flow.

p. 25 There is explicit mention of California at mid-page where the report states, "...California officials told us that if they found that a resident had an unapproved contract, the provider would be required to return all entrance and monthly fees (in total, including the costs incurred for services) to the resident." No indication is given that California regulators have ever invoked this sanction so the remedy seems to be hypothetical.

p. 27 California is again mentioned: "In California, regulators address fee increases by requiring CCRCs to include in every continuing care contract a provision that states that changes in monthly care fees shall be based on projected costs, prior year per capita costs, and economic indicators." This seems like a simple statement of good business practice and there is no California requirement that proposed fee increases be reviewed and approved by regulators prior to implementation to ensure conformity with the required contractual provision.

p. 27 The discussion of facility closures near the bottom seems inconsistent with the contractual commitment to provide lifetime tenancy. The implication here is that regulators allow closures without the consent of the residents. Since residents who are past the refund period in their contracts are deprived of the capital that they would need to be able to start over, and since they may have become frail and feeble during their residency, the strictures on closure and relocation of residents should place an obligation on the providers that is at least comparable to the burdens placed on residents.

p. 28 It's hard to conceive how any disclosure can be adequate in the absence of a full actuarial study by a fully qualified actuary, preferably a Fellow of the Society of Actuaries, to determine whether the CCRC is adequately structured, financed, and staffed to provide the commitment for lifetime services at least for the current cadre of residents over their full lifetimes. Thus the disclosure practices discussed here seem generally less than what would be desirable to enable a prospective resident to make a fully informed decision about the probability that the commitments of the proffered contract are likely to be fulfilled in practice.

This observation conflicts with the conclusion in the report that reads, "According to the regulatory history and literature we reviewed, requiring the disclosure of information about the past, present, and projected future financial conditions of CCRCs allows current and prospective residents to make informed decisions before entering a facility."

Many residents likely rely on independent, third party accreditation and regulatory oversight to give them assurance that commitments that the prospective residents are ill-equipped to analyze themselves have been reviewed by outside experts to be sure that a residency commitment is reasonable. Mere disclosure to prospective residents, of course, provides no protection at all to current residents who may be adversely impacted by managerial changes made after they move in.

p. 29 The variability of practice and the reliance on the optimistic hope that the rarity of past CCRC failures bodes well for the future shows that disclosure is inadequate as a safeguard for the trust that residents are induced to place in the CCRC managers. Almost no prospective or current residents, and few providers, have the expertise needed to fully grasp the actuarial and other implications of the comprehensive contracts and related undertakings offered by the CCRC model for eldercare. Even a fully qualified actuary, with access to the most sophisticated analytical software, would still need data beyond the most extensive disclosure data to be able to make an intelligent assessment of the viability of any given community.

p. 29 Onsite visits and examinations are more crucial for health and safety oversight (which is outside the scope of the current GAO study) than for financial matters, though billing and accounting can require site visits. The Centers for Medicare & Medicaid Services (CMS) does conduct regular onsite financial audits of those elements within its purview.

p. 30 The report again seems unaware of the requirements of Revenue Ruling 72-124 when it states, "Some states we reviewed required that CCRCs explicitly disclose policies regarding (1) the conditions under which a resident could remain in the event the

resident experiences financial difficulties, and (2) conditions under which residents would be required to move to a higher level of care. For example, Pennsylvania requires that each CCRC contract describe the circumstances under which a resident may remain at the facility in the event the resident has financial difficulties. California specifically mandates that CCRCs offering life care contracts subsidize residents who are unable to pay their monthly or other fees, provided the financial need of the resident does not arise from the resident's own action to divest of his or her assets." California also allows providers to require that residents needing financial assistance become wards of the state before qualifying for provider assistance, thereby negating the positive aspect of the CCRC living model in allowing people to provide responsibly for their own care without dependence on others and without state support.

Revenue Ruling 72-124 requires that nonprofit CCRCs maintain residents in occupancy even if their assets are depleted. The depletion is frequently attributable to fee increases after residency is taken up, so the resident is often helpless to avert the depletion. The California suggestion that residents can be evicted if the provider determines that the resident is responsible for the depletion of her or his assets can, in my experience talking with residents, cause extreme distress to residents who may become increasingly fearful of harm as they age and their powers of judgment are impaired.

p. 31 The discussion here under the caption "Other Regulatory Protections" makes clear that the role of the Resident Councils, even in the most rigorous of states, is largely passive as the recipients of disclosure information with little requirement that providers confer in a deliberative fashion with residents or heed the views of residents.

p. 33. The GAO seems to conclude that the existing patchwork quilt of existing regulation has been ineffective and no more than what the CCRCs themselves might have done as a simple matter of integrity and good business practice. "Finally, although state laws differ significantly in breadth and detail, it is not clear that CCRC residents in states with less stringent requirements are necessarily at greater risk than residents in heavily regulated states. In one state, regulators told us that despite extensive CCRC regulation, a CCRC bankruptcy cost residents the refundable portion of their entrance fees. In another state, regulators said that, while the CCRC law is not as extensive as in other states, they are not aware of any CCRCs that have faced bankruptcies or failures. In part, protection may come from the CCRCs themselves. In our contacts with CCRCs, we found that some took steps that went well beyond what the state law required."

One would not say the same for insurance regulation which has helped to ensure that the industry is soundly conducted and that insured are shielded from financial missteps

or malfeasance by insurers. Although the report does not explicitly look to the insurance model of regulation as exemplary for CCRC finances, it does so implicitly by the inclusion of the NAIC in the investigative process and Kevin McCarty, the Florida Insurance Commissioner and the chief regulator for CCRCs in that state, alluded in his remarks at the July 21, 2010 Senate Hearing to the efficacy of NAIC involvement as way to elevate CCRC regulatory standards and protections for residents.

p. 37 The close of the GAO report reiterates that the intent was primarily descriptive. “To address concerns about the risks and regulation of CCRCs, we have been asked to (1) describe how CCRCs operate and what financial risks are associated with their operation and establishment, (2) describe how state laws address these risks and identifies what is known about how adequately they protect CCRCs’ financial condition, (3) describe risks that CCRC residents face; and (4) describe how state laws address these risks and identifies what is known about their adequacy." Unfortunately, this limited perspective omits as much as it covers.

-- J. B. Cumming
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