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LIFE CARE COMMUNITIES: PROMISES AND PROBLEMS

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LIFE CARE COMMUNITIES: PROMISES AND PROBLEMS

WEDNESDAY, MAY 25, 1983

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m., in room 385, Russell Senate Office Building, Hon. John Heinz, chairman, presiding.

Present: Senators Heinz, Wilson, and Glenn.

Also present: John C. Rother, staff director and chief counsel; David Holton, chief investigator; Isabelle Claxton, communications director; Eileen Bradner, minority professional staff member; Robin Kropf, chief clerk; Angela Thimis, Kim Heil, and Linda Goldman, staff assistants.

OPENING STATEMENT BY SENATOR JOHN HEINZ, CHAIRMAN

Chairman HEINZ. Good morning, ladies and gentlemen. Today's hearing, entitled "Life Care Communities: Promises and Problems," marks the first time a congressional committee has turned its attention to this fast-growing and increasingly important housing and health care alternative for older Americans. This morning, we will examine both the promise of life care and the problems, some of them quite serious, that are associated with it [see appendix, items 1 and 2].

This year, nearly 2 million Americans will reach age 65. Over 70 percent of them own their own homes and thus control a significant source of investment capital. The vast majority of these individuals are concerned, and rightly so, that increased longevity and the increasing costs of nursing home care will conspire to destroy their financial independence.

To address this concern, we are witnessing the birth and rapid growth of a new industry known as "life care"—where, for a substantial entrance fee and a monthly service fee, an individual can be assured of lifetime housing, social services, and nursing care in a comfortable environment, where friends and cordial relations can be developed. Typically, a life care facility consists of apartments or residential units, a nursing care facility, recreation facility, and other service units in a campus-like setting. While the costs associated with life care are prohibitive for some, an estimated 60 percent of persons retiring today could afford some type of life care facility. In the last few years, the life care industry has doubled in

size to house at least 100,000 people, with annual revenues in excess of $1 billion.

Those who support life care are convinced that it is a concept whose time has come; that it can be of value to millions of Americans, and that public policy should support this industry's growth. Early studies have shown that life care residents are hospitalized less frequently and enjoy better health than others in comparable circumstances—at least in part because of the advantages that come with a convenient and affordable system of prepaid health and supportive care. But with the promise of life care have come problems associated with the financial risks inherent in making lifetime commitments of care. These risks are so serious that individuals who wish to enter life care facilities, and Government officials charged with protecting the public interest, should exercise extreme caution and close scrutiny in regard to them. The promise of life care has too often been thwarted by inept management, mismanagement, and outright fraud. As a result, in recent years, scores of life care facilities have been forced to declare bankruptcy.

Those who urge caution also point to other dangers and concerns: Residents of life care communities are given no equity interest in the facility. When bankruptcy occurs, the senior citizen residents have no standing and lose all of whatever they have paid in to the home. Many life care communities are financed as real estate ventures with endowment fees being used to cover initial construction costs. Reserves are either not established or they are set too low to cover future needs. Some life care communities are not actuarially sound and projections of future revenues and costs are incorrect. Some homes use a "cash" accounting system rather than an "accrual" system thereby grossly inflating their cash position and misrepresenting their solvency. Some life care communities represent themselves as being affiliated with a religious denomination or church, giving the impression that those entities would back the operation if any serious financial problem should develop. Quite often this claim has turned out to be false. Some contracts are written in such a way that if a person decides, even within a reasonable period of time, that he or she does not want to stay at the facility, the entire endowment is lost and not returned even on a prorated basis.

Instances have occurred where residents have not been told that the operating company was paying inflated prices for goods and services it purchased from other related—nonarms-length corporations.

As chairman of the Special Committee on Aging, I am concerned that the credibility of life care, which appears to be an attractive option for millions of older Americans, may be damaged by inept and fraudulent actions by a few. I am concerned that only 11 of our 50 States have laws governing the operation of life care facilities, and that these have often proven inadequate.

We stand today at a critical point in the development of this concept, a point at which we must inquire whether the problems we have seen can be remedied and prevented, so that its promise may be realized.

For that reason, I look forward to today's witnesses.

Before we hear from the witnesses, without objection, I am going to insert into the record the statements of Senators Larry Pressler and Chuck Grassley. They will not be able to attend today's hearing because of prior commitments.

[The statements of Senators Pressler and Grassley follow:]

STATEMENT OF SENATOR LARRY PRESSLER

Mr. Chairman, I would like to thank you for bringing together this morning's hearing. Life care communities are a concept about which many Americans know very little, and what they have heard has often been in connection with some of the more illustrious examples which have gone bankrupt. The basic concept, however, is a sound one and it deserves our consideration.

The life care industry is very small, at this point. As the numbers of older Americans continue to increase, however, it may well grow to be a major option for long-term care. Proponents of the life care concept claim that people in these communities are hospitalized less frequently and live longer than their counterparts on the "outside." Buyers of life care contracts also feel that they have a certain amount of security. In exchange for their endowment and service fees, they can usually expect guaranteed use of a living unit, utilities, meals, and unlimited nursing care, exclusive of hospitalization.

The examples of life care which many people are familiar with, however, are those that have failed. The security of those who bought into those communities was destroyed. As part of this committee's responsibility to act as an advocate for the elderly, I believe it is important for us to consider what safeguards may be necessary to protect consumers of this service. With appropriate protection for participants, life care could very well present a very valuable option for much of our aging population. I look forward to the testimony of this morning's witnesses for enlightenment on this very worthwhile subject.

STATEMENT OF SENATOR CHARLES E. GRASSLEY

This morning I congratulate Chairman Heinz and the staff of the Senate Special Committee on Aging for scheduling and preparing this morning's hearing on life care communities.

Though relatively few older Americans are members of life care communities at the present time—demographics, tax laws, and changing social mores indicate this lifestyle may provide the basic of a growth industry in the years to come.

It appears that any laws that are passed to regulate this industry should come from the State legislatures rather than Congress, however this committee is rightly performing its oversight function by investigating this subject and providing facts and opinion for a concerned constituency be they affected senior Americans or State lawmakers. I look forward to hearing and studying the testimony of this morning's distinguished witnesses.

Chairman HEINZ. We have two very distinguished panels with us. The first panel of witnesses will describe the current nature of this industry and its promise; the second will present testimony concerning the problems associated with life care as they have been demonstrated by the disastrous and allegedly fraudulent actions of one of the Nation's largest life care corporations.

Our first panel this morning consists of a number of very distinguished participants, at least one of whom I had not expected but am delighted to see again so soon—namely, Bob Ball, whom I had the pleasure of serving with on the National Commission on Social Security Reform. Knowing Bob Ball, he always turns up in the most exciting places. I in no way detract from the other members of this panel by singling him out, because they are all, each of you, very important people to what we are doing today.

In particular, this group of panelists have all been associated with the first major national research project to look at the life care industry. It is a project funded by the Robert Wood Johnson

Foundation and the Commonwealth Fund. It was conducted under the auspices of the Wharton School at the University of Pennsylvania.

The witnesses at the table are Doris Schwartz, Bob Ball, Howard Winklevoss, David Cohen, Lloyd Lewis, and the Hon. Thomas Jenkins.

In the interest of time, we have asked each witness to limit their presentation to about 5 minutes. We will, of course, accept longer written testimony and statements for the record. The members of the committee will not ask any questions of the witnesses until you have all completed your statements.

I would like to ask Doris Schwartz to be our first witness. Ms. Schwartz is 68 years old. She lives in a life care community in Gwynedd, Pa. She is a nurse and was a consultant to the Robert Wood Johnson study. Ms. Schwartz will speak from firsthand experience on what life in a well-run life care community is like.

Ms. Schwartz, welcome. We are delighted you are here. Thank you very much for coming.

STATEMENT OF DORIS R. SCHWARTZ, RESIDENT, FOULKEWAYS LIFE CARE COMMUNITY, GWYNEDD, PA.

Ms. SCHWARTZ. Thank you, Senator.

My name is Doris Schwartz. I am 68 years old. I am here today to tell you what it is like to live in a life care community.

In 1980, after 41 years in nursing, I retired from full-time employment. I am still active, and for the past 2 years, I have been a senior fellow at the University of Pennsylvania School of Nursing, acting as a part-time consultant on the faculty of the graduate program for gerontological nurse clinicians.

Some years ago, I had the opportunity to help compile an oral history of the school of nursing I was then teaching in, through tape recording oral interviews. Quite a number of those I interviewed were living in life care retirement communities, from New England to California. I visited 17 of those communities in order to obtain the interviews. Although I was not, at that time, actively trying to select a life care retirement community for my own future, I was certainly impressed and influenced by this experience, and the community in which I now live was one of those that I first visited.

All of the sites that I visited on that trip were church-related and were not-for-profit. I was amused to find that every one of those that I interviewed thought that she had found the best of all possible life care retirement communities. It seemed to me that persons with reasonably similar value systems appeared to self-sort into satisfied populations which generally worked and lived together with surprising efficiency, effectiveness, and a good deal of enjoyment. These observations have been confirmed by my own experience as a resident several years later, when I chose a life care retirement community for myself.

Older people need both independence and security, needs which are often in conflict when keeping or selecting a place to live for the later years of life.

The genius of a life care retirement community is that it offers a way of meeting both of these conflicting needs. It is a lifestyle for alert, active people who are 65 and over, and it provides lifetime security, independence, dignity, and privacy. When temporary health care is needed, most such communities permit the resident to keep his or her apartment for some time at no extra charge. If long-term care is required, the move, complete with selected pieces of one's own furniture, is likely to be a short distance, on already familiar grounds, to a setting where one remains ensconced among one's former friends and neighbors in a community where the resident has already put down roots.

Approximately 350 residents are scattered over 78 acres of a thinly wooded landscape in the community where I live. No cars interrupt the walking area. A good road surrounds the perimeter of the grounds with cutoffs to small parking lots within reach of each group of houses. Once you leave the parking lot on foot, the entire community can be traveled without meeting a car.

I like my apartment and the grounds very much. Everything is close, and living there is convenient. Resident activities are planned and coordinated by the residents' association. Some 50 residents' association committees initiate and carry out a diverse selection of recreational programs, such as trips, classes, lectures.

One comment on administrative style and also on style in residents' associations. There are some which say, in effect, "You have worked hard all your life. Now let us take care of you." Others say, "You have worked hard all your life. You will probably want to keep right on doing it. There is plenty of work here within the residents' association, and your contribution will help us all enjoy a better community." My own community is definitely of the latter persuasion.

I would like to end with a brief thought, a quote from one of our residents. Her advice is, "In selecting a life care community, look at the residents' faces even more carefully than you do at the facilities. You will know whether you are looking at faces among whom you will want to spend the rest of your life."

Chairman HEINZ. Thank you very much, Ms. Schwartz.

[The prepared statement of Ms. Schwartz follows:]

PREPARED STATEMENT OF DORIS SCHWARTZ

My name is Doris Schwartz. For the past 2 years, I have been a senior fellow at the University of Pennsylvania School of Nursing, acting as a part-time consultant on the faculty of the graduate program for gerontological nurse clinicians, teaching some classes in that program and helping with the faculty's coordination of the Robert Wood Johnson Foundation's teaching nursing home program.

In 1980, after 41 years in nursing I retired from full-time employment. I was then codirector of the New York Hospital-Cornell Medical Center's geriatric nurse practitioner program for graduate nurses. Some years earlier, I had had the opportunity to help compile an oral history of the school of nursing I was teaching in, through tape recording interviews with elderly faculty of long ago. Quite a number of them were living in "life care retirement communities" from New England to California and I visited 17 of these communities in order to obtain the interviews. Although I was not, at that time, actively trying to select a life care retirement community for my own future, I was certainly impressed and influenced by this experience and the community in which I now live was one of those I first visited in this way.

All the sites I visited on that trip were church-related and not-for-profit. All were ecumenical in their resident population but were sponsored by different faiths and various denominations. I was amused to find that every one of my interviewees was

sure that she had found the best of all possible life care retirement communities and I discovered that most of these settings tended to attract new residents by word of mouth and by potential applicants being shown around by those already living there. It seemed to me that persons with reasonably similar value systems appeared to self-sort into satisfied populations which generally worked and lived together with surprising efficiency, effectiveness, and a good deal of enjoyment.

All in all, I found most of my interviewees among diversified and well-educated groups of fellow residents.

These observations have been confirmed by my own experience as a resident several years later, when I chose a life care retirement community for myself.

Older people need both independence and security, needs which are often in conflict when keeping or selecting a place to live, for the later years of life.

The genius of a life care retirement community is that it offers a way of meeting both these conflicting needs. It is a lifestyle for alert active people who are 65 and over and it provides lifetime security, independence, dignity, and privacy. When temporary health care is needed, most such communities permit the resident to keep his or her apartment at no extra charge. If long-term care is required, the move, complete with selected pieces of one's own furniture is likely to be a short distance on already familiar grounds to a setting where one remains ensconced among former friends and neighbors in a community where the resident already has roots.

Let me tell you about my apartment. The view is lovely. It's like living in a treehouse. The studio has a balcony which looks directly into a tall pine tree and through it, at a distance, to the woods. One looks down onto other people's pocket-handkerchief sized, jewel-like gardens at close range—perhaps 30 of them are visible between the buildings and the woods. The apartment entrance on the side opposite the balcony is on a sort of aerial walkway much like the deck of an ocean liner, arranged around a grassy quadrangle. That door, too, if left open with only the screen door closed, looks directly into another treetop. Morning sun enters across the balcony, sunset shows over the aerial walkway. There is a tiny pullman kitchen, and an enormous bathroom. Although the apartment—one room—is small, the furniture fits in well and when pictures and mirrors go up is lovely and homey.

Approximately 350 residents are scattered over 78 acres of thinly wooded landscape. No cars interrupt the walking area; a good road surrounds the perimeter of the grounds with cutoffs to small parking lots within reach of each group of houses. Once you leave the parking lot, on foot, the entire community can be traveled without meeting a car.

Life care retirement communities are a reasonably recent lifestyle. Foulkeways, the one I am living in is a nonprofit retirement community which is operated under the direction of members of the Society of Friends. Its 18 directors come from the fields of medicine, engineering, college education, banking, community outreach, law, construction, e.g., the American Friends Service Committee, hospital administration, another retirement community and business. The board is interracial in its makeup.

Administrative affairs are run by an executive director and professional staff. There is a health center advisory committee and a joint advisory council each made up of administrative staff and resident members to pool suggestions and facilitate communications.

Resident activities are planned and coordinated by the residents' association. Some 50 residents' association committees initiate and carry out a diverse selection of recreational programs such as trips, classes, and lectures.

Of course, one of the things a resident does is put immense trust in the board and administrators of the community. In the matter of governance, one gives up a certain amount of individual autonomy: All policy decisions about admissions, investments, and further growth of the plant become the board's responsibility.

One comment on administrative style, and also on style in resident's associations: There are some which say, in effect, "You've worked hard all your life. Now let us take care of you." While others say, "You've worked hard all your life. You'll probably want to keep right on doing it. There's plenty of work, within the residents' association and your contribution will help us all enjoy a better community." My own community is definitely of the latter persuasion.

I'd like to end with a brief thought: A quote from one of our own residents, "In selecting a life care community, look at the residents' faces more carefully even

than you do at the facilities. You'll know whether you're looking at faces among whom you'll want to spend the rest of your life."

Chairman HEINZ. Our next witness is Bob Ball. I mentioned that I served with him, but he has served under three Presidents—as Commissioner of Social Security, 1962 to 1973, and he has served most recently as chairman of the advisory committee to the Robert Wood Johnson Foundation which funded the study of life care communities conducted by the Wharton School at the University of Pennsylvania.

Bob, maybe you can help provide us with an overview of the findings made by the first national study of life care.

STATEMENT OF ROBERT M. BALL, VISITING SCHOLAR, CENTER FOR SOCIAL POLICY, WASHINGTON, D.C.

Mr. BALL. Thank you, Mr. Chairman.

I might say first that this was a very active advisory committee that had, I think, a real influence on the study. The members of the committee came from many different fields. The three people on my right were members of the advisory group, and the two people on my left were important members of the staff conducting the study.

The results of the study are being published in two parts. The first part, a reference directory of continuing care retirement communities, has already been published, and that is out and available. It is a listing of just about all the communities that meet the study definition. And then the second part, which is principally an analysis of the accounting, actuarial, and legal problems in the field, will be published this summer.

Today, there are about 275 continuing care retirement communities, which we have come to call CCRC's, in the United States, where some 90,000 elderly people with an average age of 80 live independently in their own apartments, but have the opportunity for eating together, group recreation, and other activities that come from being part of an organized community.

Most importantly, in addition to having immediately available a variety of health and social services which they can call on according to their desires and needs, the residents have a virtual guarantee that they will be adequately taken care of no matter what happens to their health. The fear of some day being a burden on relatives or friends, or finding oneself helpless among uncaring strangers, is effectively removed.

It is this health care guarantee that principally distinguishes CCRC's from other retirement communities. They provide insurance against the cost of long-term care, and they supplement the coverage of acute health care costs paid for largely by medicare and private insurance. The unique feature is that this otherwise unobtainable full insurance is provided in combination with independent living arrangements which the resident can enjoy as long as health permits.

The communities are almost all nonprofit and came into being under church auspices, usually one of the Protestant denominations. The intent is for the communities to be self-supporting with

the residents "paying their own way"—that is a lot of what this book that will be coming out this summer is about.

The financing method, as you indicated, Mr. Chairman, combines a sizable entrance fee—the average at the time of the study was $35,000 for a single person entering the home and $39,000 for a couple—and then a monthly payment which is adjusted from time to time for inflation and occasionally for other factors. The average at the time of the study for the monthly fee was $600 for a single person and $850 for a couple.

The advisory group to this study has come to feel that we may be on the threshold of a major expansion of these communities. After all, they are obviously serving a tiny proportion of those who could afford this kind of care when you have 90,000 residents, out of a total population over 65, of 26 million. The reason that we think we might be on the edge of an expansion is that for the first time, really quite large numbers of the very old—although I would think still a somewhat smaller percentage than the 60 percent that the staff is talking about, but still a large percentage, relatively—are for the first time able to meet the costs of these living arrangements combined with what is essentially a new form of insurance.

Now, obviously, this is only one of several possible arrangements that the elderly may want to select in the future, but it is attractive to many of those who no longer can or want to maintain individual homes, and the present communities tend to have long waiting lists. It seems to me very good that this committee, and others, are beginning to examine now how these communities can best be financed in a way that protects the rights of current residents, and at the same time, makes the continuation of the community economically feasible. The Wharton School study is an initial examination of the actuarial, financial, accounting, and legal issues involved in such an endeavor.

Mr. Chairman, I would like to stop at this point. I do have a longer statement that I would like, with your permission, to submit for the record.

Chairman HEINZ. Without objection.

Mr. BALL. The rest of it deals largely with some of the data about homeownership and the income of the elderly that gives some kind of a feel for the extent to which people might be able to afford these arrangements.

Chairman HEINZ. I am going to have a few questions for you on that point at the conclusion of the testimony.

Thank you very much.

[The prepared statement of Mr. Ball follows:]

PREPARED STATEMENT OF ROBERT M. BALL

Mr. Chairman and members of the committee, my name is Robert Ball. From April 1962 until March 1973, I was Commissioner of Social Security, serving under Presidents Kennedy, Johnson, and Nixon. Prior to becoming Commissioner, I served for approximately 20 years in various positions in the Social Security Administration and its predecessor organization, the Social Security Board, and for the 10 years prior to becoming Commissioner, I was the top civil servant in the Social Security organization. Since leaving the Government, I have continued my deep interest in programs benefiting the elderly and have written and lectured extensively on the subject. I am currently a visiting scholar at the Center for the Study of Social Policy and senior consultant to the Study Group on Social Security.

I was a member of the National Commission on Social Security Reform whose report formed the basis for the social security legislation that was signed into law by the President on April 20, 1983. I am appearing today, however, as chairman of the advisory committee on the continuing care retirement community study recently completed by the Wharton School of the University of Pennsylvania. The results of this study are being published in two parts. The first part, a reference directory of continuing care retirement communities, was published last year. The second part, principally an analysis of the accounting, actuarial, and legal problems in the field, will be published this summer.

Today, there are about 275 continuing care retirement communities (CCRC's) in the United States where some 90,000 elderly people (average age about 80) live independently in their own apartments, but have the opportunity for eating together, group recreation, and other activities that come from being part of an organized community. Most importantly, in addition to having immediately available a variety of health and social services which they can call on according to their desires and needs, the residents have a virtual guarantee that they will be adequately taken care of no matter what happens to their health. The fear of some day being a burden on relatives or friends or finding oneself helpless among uncaring strangers is effectively removed.

It is this health care guarantee that principally distinguishes CCRC's from other retirement communities. They provide insurance against the cost of long-term care, and supplement coverage of acute health care costs paid for largely by medicare and private insurance. The unique feature is that this otherwise unobtainable full insurance is provided in combination with independent living arrangements which the resident can enjoy as long as health permits.

The communities are almost all nonprofit and came into being under church auspices, usually one of the Protestant denominations. The intent is for the communities to be self-supporting with the residents "paying their own way."

The financing method combines a sizable entrance fee (average $35,000 single and $39,000 a couple at the time of the study), with a monthly payment which is adjusted from time to time for inflation and occasionally other factors (average $600 single and $850 a couple).

It is just possible that we may be on the threshold of a major expansion of these communities because for the first time large numbers of the very old—although still a small percentage of the total—are able to meet the cost of these living arrangements combined with what is essentially a new form of insurance. The CCRC is, of course, only one of several possible arrangements that the elderly may want to select in the future, but it is attractive to many of those who no longer can or want to maintain individual homes, and the present communities tend to have long waiting lists. It seems to me well that we examine now how these communities can best be financed in a way that protects the rights of current residents, and at the same time makes the continuation of the community economically feasible. The Wharton School study is an initial examination of the actuarial, financial, accounting, and legal issues involved in such an endeavor.

The data is not available for a good current estimate of the proportion of people in the age group most likely to be interested in CCRC's (those over age 75) who could afford to pay the cost, but the number is clearly many times greater than those now living in these communities. While the retirement history survey data of the Social Security Administration show that saving in the form of liquid assets—bank accounts, stocks and bonds, and so on—are not sufficient for the entrance fee for all but a relatively few elderly persons,[1] selling a home could provide the answer for many. The 1979 annual housing survey showed that nearly 73 percent of those over 65 owned homes in 1979. The average value of the homes was estimated to be $46,600 and by now is undoubtedly more than $50,000. About 80 percent of elderly homeowners have paid off their mortgages and the ratio of outstanding debt to home value was found by the 1970 survey of residential finance to be 0.24 for other elderly owners. Thus, over 90 percent of the total value of the housing stock owned and occupied by those over 65 is homeowner equity. In all probability then, the sale of a home would supply a sufficient downpayment for a CCRC for a very large number of elderly persons.

Obviously, not all of these homeowners would be interested in exchanging their homes for life in a continuing care retirement community, and many would not be able to count on income that would keep up with the monthly payments, but an increasing number would be able to do so. The base for making the monthly pay-

[1] Joseph Friedman and Jane Sjogren, "Assets of the Elderly As They Retire," Social Security Bulletin, 44, No. 1, January 1981.

ment for a CCRC affordable is, of course, the inflation-proof social security benefit, although few people who depend solely on social security are likely to be good CCRC prospects in the near future. For those receiving social security benefits near the maximum, and taking into account that the benefits are protected against increases in the cost of living, social security alone is enough even after taxes are taken into account, but the margin is small. (The maximum benefit for a couple when the worker retires at 65 is now about $1,100 a month, but few get the maximum.) However, for those who get some private pension benefits in addition to the upper range of social security, total income will frequently be enough to meet the CCRC monthly payment. (Since private pensions are seldom indexed to the cost of living at all, and never indexed fully on a contractual basis, the income from non-social security sources probably needs to be at least twice what is currently necessary in trying to determine whether an individual has sufficient income to meet not only present monthly payments but the monthly payments as they will be increased over the resident's lifetime. The military and Federal civil servants have full inflation protection and their retirement benefits, like social security, can be assumed to rise approximately with increase in the monthly fees.)

In spite of all these qualifications, the universe of those who can afford CCRC's is already quite large and getting larger. In 1981, about 40 percent of the couples with one person over 65 received a private pension or a career government pension and most received a social security benefit in addition. The figure for single individuals was slightly over one-fourth. It is true that for most people retirement pensions other than social security are small—the median amount in 1981 for couples was about $3,700 a year, and for single individuals about $2,400—yet added to social security the private pension supplement makes it so that many can now afford CCRC's.

All in all, it seems to me that it can be said at this point that CCRC's, on a self-financed basis, are a possible alternative for many times the number of people who are now residents. They are not something that only the "wealthy" can afford, as is sometimes alleged, but neither—at least in the form now in existence—are they affordable for the average person 75 or over. In their present form, at least, they are certainly not an answer for the poor, the near-poor, or even the "low-income elderly." In my opinion, this does not make them unimportant when viewed as a private endeavor to serve the needs of the very large number of elderly persons who have somewhat above-average incomes and can pay fully for such a service. We have the programs now in place that will increase the number of relatively well-off older persons in the future, and it is also possible that some CCRC's will be developed that can serve a somewhat lower income group, still on a self-sustaining basis.

I think the future for these communities looks good, but certainly not as a substitute on a large scale for more universally available home care and other long-term arrangements.

Chairman HEINZ. Our third witness is Dr. Howard Winklevoss. Dr. Winklevoss, president and founder of Winklevoss & Associates, is an adjunct professor of insurance at the Wharton School of the University of Pennsylvania. Before starting Winklevoss & Associates, he was director of the actuarial science program at the Wharton School. Recently, as Bob Ball mentioned, Dr. Winklevoss acted as project director of the Robert Wood Johnson Foundation study of life care communities.

Dr. Winklevoss, we welcome you. Please, proceed.

STATEMENT OF HOWARD E. WINKLEVOSS, PH. D., ACTUARY, WINKLEVOSS & ASSOCIATES, PHILADELPHIA, PA.

Dr. WINKLEVOSS. Thank you, Mr. Chairman.

I have a prepared statement that I would like to submit.

Chairman HEINZ. Without objection, so ordered.[1]

Dr. WINKLEVOSS. And I would like to spend just 5 minutes summarizing some of the financial aspects of our study. One of the questions that is often asked is "What is the current financial

[1] See page 12.

status of life care communities?" Unfortunately, we do not know. And, more unfortunately than that, it requires a great deal of effort to assess the financial status of each of these organizations.

Through the study and through the consulting work of my firm, we have performed fairly extensive analyses on about 15 life care communities. Half of those communities were found to be in just excellent financial condition. Approximately half of them were found to be in not very good financial condition. Now, that is not a good representative sample for the following reason: The consulting studies that we have undertaken are generally done at the request of a community that is facing financial difficulty. So you can see that the 15 studies that we have looked at are not necessarily representative of the entire country, and I would not want it to be interpreted that half of the communities are not in good financial condition.

The next question might be, how can one assess the financial health of a continuing care retirement community. There are approximately eight chapters in our book on precisely how to do that. The material in the book is not something that we invented, but simply, the application of an age-old science called actuarial science to life care communities. My research activities at the Wharton School for the last 13 years have been in the pension area, and as you know, there are thousands of pension plans in this country which are required by Federal law to perform, or to have performed on them, at least once every 3 years an actuarial valuation. A valuation assesses whether or not the current stock of assets plus future contributions will be sufficient to cover the future deferred liabilities.

We took that same methodology and applied it to continuing care retirement communities, and while admittedly, it is somewhat more complicated, it is nevertheless the definitive measure of whether or not a community is currently on the right track of funding its long-term deferred health care obligations. Some people say that retirement communities only have 300 or 400 people, and all the actuarial science that you bring to bear on the issue is not relevant, because the group is too small. Well, that is just not a true statement. There are problems with a small group, and there are thousands of pension plans with 10 or 15 employees, and somehow, they seem to proceed on a financially sound basis with the help of actuarial valuations.

What about the industry's receptiveness to actuarial planning? I will just tell you my personal experience in connection with the consulting division of our corporation. Over the last 4 or 5 years, we have sent out numerous invitations to the CCRC to have actuarial valuations performed on them. Those invitations have met with very little success. In fact, I think two or three financially distressed communities have come to us and said, "Would you help us out?" For some reason which is not entirely clear to me, the communities' management are reluctant to have professional actuaries perform the sorts of analyses that are clearly called for in a situation like this. I say that because in effect, what they are doing is selling, so to speak, lifetime health insurance to people aged 75. And I can assure you that if the insurance industry were to engage in that type of a product, there would be a very careful analysis by

professional actuaries as to whether or not the premium structure is viable and will maintain its viability.

Well, how would one encourage the industry to increase their degree of financial management in this area? One thing you could do is pass a law, a Federal law or a series of State laws, to encourage that. That is certainly one way to do it. The last time I testified before Congress was 10 years ago when the pension bill was about to be passed, and I was a very enthusiastic supporter of that bill. Some of my older colleagues said, "Howard, you might want to think about big laws. They do not always work out the way you would like them to." And sure enough, the law did not work out as well as I would have liked it to.

Chairman HEINZ. It has been good for actuaries, I think.

Dr. WINKLEVOSS. Oh, it has been wonderful for actuaries, yes.

So I am reluctant to encourage you to pass wholesale laws to regulate the industry on the one hand, but what we do need is something to make life care communities, which are a wonderful concept, financially sound. What is needed for their continued growth is professional management, both on the actuarial side, the marketing side, and every other facet of management, because it is a business, and with that sort of management, I believe we might overcome this potential danger of a few bad apples ruining the entire barrel. That would be most unfortunate, in my personal opinion.

Thank you.

Chairman HEINZ. Dr. Winklevoss, thank you very much.

[The prepared statement of Dr. Winklevoss follows:]

PREPARED STATEMENT OF HOWARD E. WINKLEVOSS

In terms of financial management, a CCRC is analogous to a pension plan in several respects. In both cases, revenues are received in advance of the cash payments required for meeting promised benefits. For a pension plan, funds are accumulated during a participant's working years in order to pay for benefits after retirement. Similarly, the payment of an entry fee plus recurring monthly fees is designed to advance fund the cost of future health care for a CCRC resident.

There is a tontine element in the operation of both pension plans and CCRC's. For a pension plan, funds are set aside in respect of a participant for each year of service rendered to the plan sponsor; however, only those participants meeting certain eligibility requirements will receive benefits. A participant who works only a few years and then terminates employment may never receive benefits from the plan. The same phenomenon exists with respect to a CCRC in that all individuals contribute an entry fee, plus monthly fees thereafter to fund the high costs of extended health care, even though only those who become ill benefit financially from such advance funding.

There are many ways to fund a pension plan, but one acceptable approach is to set employer contributions equal to a level percentage of payroll each year. In other words, the dollar costs of the plan will increase, but only by an amount equal to the increase in payroll which typically equals the inflation exposure of the plan sponsor. Similarly, the monthly fees of a CCRC can, and should, be designed to increase by the inflation to which the community is exposed (not necessarily equal to published indices such as the CPI). In order to accomplish this, however, a new CCRC must charge fees that will advance fund the increase in health care costs that will occur during the first 10 to 15 years of its operation. If fees are established on a strict real estate approach, the effects of inflation plus the increased cost of higher health care utilization will almost assuredly force fees to be increased by more than inflation alone in order to maintain financial soundness.

In estimating the contributions needed to meet the obligations of a pension plan, the plan's actuary must make assumptions about the plan's experience for many years into the future—in some cases 20 to 40 years or more. Since the experience of the plan will inevitably deviate from these assumptions, the actuary calculates the

financial consequences of such deviations and adjusts contributions accordingly. The same problem exists with CCRC's. Each year the experience of the community should be checked against the assumptions used to set fees, with the deviations being factored into the following year's fee adjustments. This is particularly important when dealing with small pension plans and, of course, with CCRC's where the resident population typically totals only a few hundred individuals.

One of the ways a CCRC differs from a pension plan, however, is in the physical plant, or real estate, aspect. A CCRC must anticipate, financially, the cost of refurbishing its facility (and eventual replacement or major renovation) and the replacement of other fixed assets. These items must be factored into the pricing structure of a CCRC. If they are not advance funded in a manner similar to the advance funding of future health care costs, then there is little hope that the community's fee increases can be held down to the rate of inflation.

The real estate aspect of CCRC's complicates the financial arrangement and leads some managements to price (and market to prospective residents) the CCRC concept on the basis that entry fees are designed to cover the cost associated with the real estate portion of the transaction, while monthly fees (from all residents) are set to cover operating costs. While it is true that this pricing approach may in fact be adequate, it is an oversimplification of the true nature of a CCRC and its financial obligation to residents.

There is a well-defined scientific approach to funding a pension system, based on actuarial mathematics, and this same science can, and should be applied to establishing fees for a CCRC. Whereas the real estate approach may, by chance, establish fees that will maintain the long-term financial solvency of a CCRC, the actuarial approach attempts to achieve this goal by design.

Actuarial science, which has been applied to pension plans for many decades and is now required by law to be applied to all private pension plans, has seldom been applied to CCRC's.

CURRENT PRACTICE

It is a common belief within the CCRC industry that, although the goals and characteristics of a CCRC pricing structure are complex, the financial soundness of a given pricing policy can be adequately addressed by projecting the community's cash flow over a period of years. This belief hinges on the assumption that so long as fees generate revenues sufficient to service the community's debt and to cover operating expenses and depreciation is funded, the community is assumed to be financially sound. Communities employing this approach, particularly new communities, have not addressed some of the most important and fundamental financial issues involved with CCRC's, such as assessing and funding the future health care obligation of current residents or defining reserve level targets and setting fees to generate liquid assets to meet such targets. In fact, cash flow analyses can promote a false sense of security in as much as they can mask a serious long-term financial problem, whereas the actuarial methodology is designed to uncover such problems.

To illustrate the dangers of relying on cash flow analyses, four hypothetical cases have been constructed to represent different pricing policies that might be adopted by competing CCRC's that are assumed to be opened recently. All four communities are identical in size and construction costs, offer the same contracts (extensive health care guarantees), and have the same expense and health care utilization experience. The only difference among the communities is the initial (and subsequent) fees, and the first case if assumed to have a smaller debt ($12 million versus $15 million) since a larger portion of its entry fees were applied to construction costs.

The first year fees for one bedroom apartments for each case are given in table 1. Fees for case No. 1 were established such that expected cash receipts match expected cash disbursements. This implies, of course, that monthly fees must increase faster than the community's inflation rate in order to keep pace with expenses that are additionally affected by the increased health care utilization during the community's maturation.

Fees for case Nos. 2 through 4 are based on the policy that a significant portion of initial entry fees for the first generation of residents is held in reserve (the amount of the first year reserve is the same in all cases). The fees for case No. 2 were derived on the basis of having what appeared to be a favorable 5-year cash flow projection. Case No. 3 fees were based on the goal of maintaining a positive cash flow over 20 years. Its monthly fees are the same as case No. 2; however, its entry fees are approximately 11 percent higher. The fees for case No. 4 are actuarially based, with monthly fees approximately 5 percent higher than those charged for case Nos. 2 and 3, and entry fees approximately 11 percent higher than case No. 2 (i.e., the same as

case No. 3). In all three cases, both monthly fees and entry fees are assumed to increase for inflation.[1]

TABLE 1.—BASE YEAR 1-BEDROOM FEES FOR A SINGLE ENTRANT

	Monthly fee	Entry fee
Case number:		
1	$468	$39,097
2	684	46,916
3	684	52,129
4	720	52,129

The expected end-of-year cash balance for each pricing is presented in figure 1. Case No. 1 has a relatively small cash balance throughout the forecast. At the end of the first 5 years, case Nos. 2 through 4 hold $11 to $16 million in cash. However, extending the projection for another 15 years shows that the pricing policy underlying case No. 2 is seriously inadequate. Its cash balance increases for 8 years and then decreases to under $1 million by the end of 20 years (in today's dollars, adjusting for inflation, the cash balance would have declined continuously from $9,069,000 to $136,009). Although management may not have continued the same underpricing policy in light of declining cash balances, this example illustrates the potential problems of using short-term cash flow analyses.[2]

Even if a long-term cash flow projection is made, management may still not be provided with sufficient information for selecting among competing pricing policies. For example, consider the expected cash flows associated with case Nos. 3 and 4. Although both cases generate large cash balances by the end of 20 years, a cash flow analysis itself does not provide a justification for the $54 million ($8 million in today's dollars) accumulated under the so-called "actuarial policy." Nor does it provide a justification for the accumulation of $27 million ($4 million in today's dollars) associated with case No. 3.

[1] This rate varies, depending on the expenses that monthly fees and entry fees are designated to cover. The long-term inflation rate is assumed to be 10 percent for illustrative purposes.

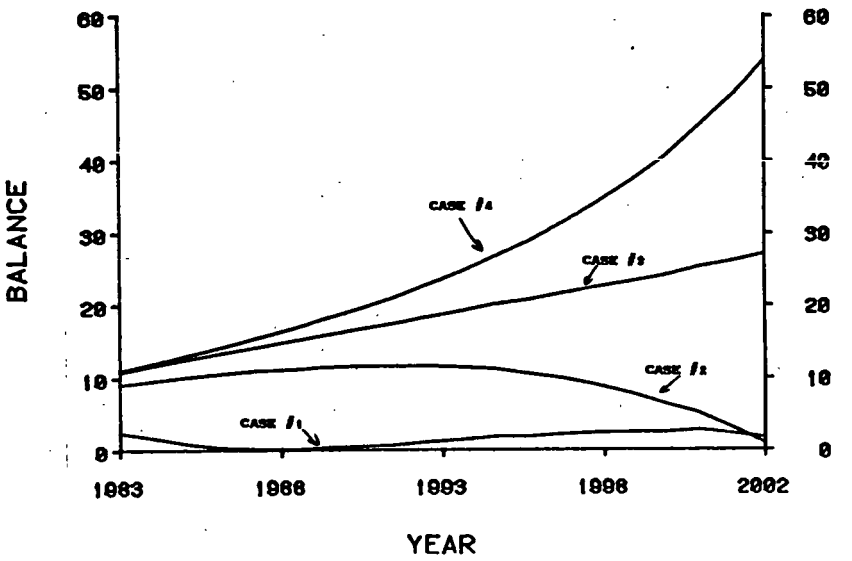
[2] Although the values projected 20 years from now are different from the ones that will actually occur, the purpose of long-term projections is to provide the community ample time to make modest fee adjustments currently in order to avoid undesirable trends instead of having to make more severe adjustments at a later point.

FIGURE 1

EXPECTED END OF YEAR CASH BALANCES

UNDER FOUR PRICING POLICIES

(DOLLARS IN MILLIONS)



Another deficiency of using projected cash flows alone for management decision-making is that a long-term projection might show positive expected cash balances while the probability of a negative cash balance due to random deviations from the underlying assumptions might be extremely high. Table 2 shows the implications of random deviations in two key assumptions used to project future cash flows—apartment turnover and health care utilization. The pricing policy selected by management should minimize the probability of having to borrow money to cover negative cash balances. Case No. 1 shows a high probability of a negative cash balance, ranging from 15 to 45 percent after the third year. Case No. 2 also shows a positive probability of a negative cash balance after 16 years. The probability of a negative cash balance due to random deviations is zero for case Nos. 3 and 4. This table illustrates a flaw in the use of cash flow analysis based on expected values, since management does not have information on the risks associated with random deviations.

Even if a cash flow analysis involves a long-term projection (20 years or more) and generates information on the risks associated with random deviations, it is still not a sufficient tool to help management select among various pricing policies. In order to select a prudent pricing policy for a CCRC, management must not only look at cash flows, and the potential variability in cash flows, but also identify the size of the deferred obligations to continuing care contractholders and establish a pricing policy to fund that obligation (or some financially acceptable portion thereof).

Unfortunately, the existing literature on CCRC's does not contain a set of financial guidelines, or pricing and financial evaluation methodology, that allows management to address these pertinent issues.

TABLE 2.—PROBABILITY OF SHORT-TERM CASH DEFICITS DUE TO RANDOM DEVIATIONS UNDER FOUR PRICING POLICIES

[In percent]

Fiscal year	Pricing policy			
	Case No. 1	Case No. 2	Case No. 3	Case No. 4
1983	0	0	0	0
1984	0	0	0	0
1985	0	0	0	0
1986	15	0	0	0
1987	45	0	0	0
1988	40	0	0	0
1989	30	0	0	0
1990	25	0	0	0
1991	20	0	0	0
1992	20	0	0	0
1993	15	0	0	0
1994	15	0	0	0
1995	20	0	0	0
1996	30	0	0	0
1997	30	0	0	0
1998	30	0	0	0
1999	30	15	0	0
2000	30	20	0	0
2001	35	30	0	0
2002	45	40	0	0

OBJECTIVES OF PRICING METHODOLOGY

There is considerable variability among CCRC's. Communities do not fit one mold, but retain their individual identity by offering variations that meet their own philosophy on serving the elderly. Just as each community's management has different ideas about the services they should provide to residents and the structuring of the physical plant, managements also vary on their ideas for setting fees. At one extreme, management could set fees that are actuarially adequate, following a pure actuarial approach where fees vary according to the resident's entry age, sex, apartment type, health status at entry, and so forth. At the other extreme, all residents could be charged the same fees.

Typically, the fees for CCRC's fall betweeen these two extremes. For example, fees tend to vary by the apartment type and number of apartment occupants. Some communities allow residents who have permanently transferred to the health care center to pay the same fees they did before permanent transfer. Other communities require that all health care residents pay a uniform fee. All of these variations in pricing structures are based on management's objectives. Therefore, one of the pricing methodology goals should be that it not dictate such objectives, but rather inform management whether or not its pricing structure as a whole, or in aggregate, is financially sound, leaving decisions of equity among current residents and among successive generations of residents to management discretion.

In the preceding section, the cash balances associated with the two acceptable pricing policies (case Nos. 3 and 4) might seem extremely large for a nonprofit operation. This could pose a problem in trying to extract fee increases from residents who might feel that such balances are unnecessary and inappropriate "profits." Therefore, a second pricing methodology objective is that it provide a basic for justifying the size of a community's assets and the need for continued fee increases both to management and residents. This objective is closely related to the types of financial statements (both internal and external) that are developed by the community. Such statements for most communities are prepared according to generally accepted accounting principles (GAAP). Such statements must be modified to present a financial picture consistent with the community's actuarial position and the pricing methodology should provide guidance for such modifications.

Finally, any organization that offers a continuing care contract is committing itself to a long-term venture. Even though the typical resident is expected, on average, to survive 12 to 14 years in the community, a certain percentage will survive 20

years or more. This means that the methodology used to set fees must determine whether such fees will support current residents over this potential (not just expected) lifetimes in the community. Moreover, the methodology should require that management set policies to help insure the continued operation of the community, such as setting aside funds to replace equipment and furnishings, as well as the eventual replacement of the facility. Since new entrants are an important component of the success of the ongoing community, management will also need to set aside reserves for future refurbishments and/or modernization to maintain the facility's attractiveness to prospective residents.

ALTERNATIVE PRICING METHODOLOGIES

Three generic pricing methodologies used by actuaries in connection with pension plans are: (1) Pay-as-you-go, (2) open group, and (3) closed group. These three methods, in fact, were used in the cash flow projections for case Nos. 1, 3, and 4, respectively. The pay-as-you-go method looks at one year at a time, setting current fees at a level sufficient to cover current expenses. The open-group method examines a fixed period of years, such as 20 years, and determines current and projected fees such that their present value equals the present value of current and projected expenses for all residents (current plus new entrants) during the period. Under this approach, current fees generally will be higher than current expenses in anticipation of the increased health care utilization and the reserving for future fixed asset expenditures. The closed-group method is based on the goal that fees for a cohort group of residents (typically each group of new entrants) are set to cover their anticipated expenses over their remaining lifetimes in the community. This method differs from the open-group method since it separately examines each cohort and requires that fees be self-supporting without the benefit of new entrants' fees.

A comparison of the three pricing methodologies is given in table 3, based on five characteristics: (1) Relative fee levels; (2) simplicity of determining annual fees; (3) ability to maintain inflation-constrained increases in monthly fees; (4) ability to achieve group equity; and (5) size of contract termination reserves. The comparisons are presented for both a new (or maturing) community and a mature community.

TABLE 3

Comparison of Alternative Pricing Methdologies

Community Age	Pricing Method	Characteristics				
		Fee Levels	Simplicity of Fees	Maintenance of Inflation-Constrained Monthly Fees	Group Equity	Contract Termination Reserve
Maturing	Pay-as-you-go	Lowest	Easy	Difficult	Difficult	None
	Open group	Intermediate	Complex	Possible	Possible	Partial to Full Funding
	Closed group	Highest	Complex	By Definition	By Definition	Full Funding
Mature	Pay-as-you-go	Highest	Easy	Difficult	Difficult	None
	Open group	Intermediate	Complex	Possible	Possible	Partial to Full Funding
	Closed group	Lowest	Complex	By Definition	By Definition	Full Funding

Fee levels

Since most communities are nonprofit, a common goal is to offer the maximum service at the lowest possible cost to residents. A constraint on this policy is that communities do not wish to set fees so low that their financial stability is jeopardized.

For a new community, the pay-as-you-go method requires the lowest fees while the closed-group method generates the highest. However, if a community adhered to

these policies to maturity, pay-as-you-go will have the highest fees while the closed-group will have the lowest. The reason for this difference is that under the closed-group method, initial fees will be higher than initial expenses, generating reserves that produce interest income in later years. The interest income, in turn, serves to cover a portion of the expenses and, therefore, allows fees to be lower than the pay-as-you-go method. This phenomenon also occurs with the open-group method, but generally to a lesser extent than for the closed-group method.

Simplicity of preparing financial projections

The second characteristic in table 3 refers to the difficulty of developing projections to determine annual changes in fees. Pay-as-you-go is the easiest method to employ, since it requires that revenues equal expenses for only a 1-year projection. Both the closed-group and open-group approach are more complex.

Maintenance of inflation—constrained monthly fees

Limiting increases in monthly fees to the internal inflation rate of the community is a desirable goal for a CCRC. The closed-group method, by definition, establishes fees to meet this objective. It is possible to achieve this goal with open-group pricing as well. Fee increases under the pay-as-you-go method depend on the rate of increase in expenses, which typically increase by more than inflation because of increased health care costs.

Group equity

Group equity, another desirable goal for CCRC's, implies that fees for a cohort group of residents (typically a new entrant cohort) are set such that they cover all future expenses allocated to that group. Thus, the fees for each cohort are self-supporting and require no intergenerational transfer of funds. The only method that accomplishes this goal by definition is the closed-group approach. It is virtually impossible to achieve this objective using pay-as-you-go, and difficult to achieve under the open-group approach, since neither of these methods sets fees to be adequate for a cohort group, but rather, relies on new entrants to maintain the community's financial soundness.

Contract termination reserves

Many communities state that it is their policy to offer continuing care contracts for the foreseeable future. However, recent experience shows that this has not been possible for some communities, even though they may have wished to continue. The reasons for the discontinuation are varied; some are caused by fluctuations in the marketplace and others by failure to set fees properly during their earlier years after startup.

The contract termination reserves refer to the ability of the community to cover its future liabilities for continuing care contractholders in the event that the community decides to no longer offer such contracts.[1] Fees under the closed-group method will generate sufficient reserves to liquidate (close out) the liabilities associated with current residents while maintaining inflation-constrained monthly fees. The open-group method partially funds such reserves, and in some cases may result in full funding. The pay-as-you-go approach does no funding in this regard. Thus, if continuing care contracts were no longer offered to new entrants, management would have to increase the surviving continuing care contractholders' fees by more than inflation and/or subsidize a portion of the liability from other sources.

SUMMARY

The pay-as-you-go method is an extremely risky approach for a new community, especially in an inflationary environment. Existing communities that have already reached a mature state may find this approach to be satisfactory; however, it does not provide the financial security that the authors believe is appropriate for CCRC residents.

The open-group method can provide a satisfactory approach to pricing a CCRC, but there may be a temptation to select a planning horizon and assumptions that postpone too large a portion of current expenses to future periods.

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[1] Alternatively, it can be viewed as the strength of the pricing methodology to withstand financial variations that might otherwise cause it to change the contractual guarantee offered to prospective residents.

The closed-group method does not suffer from the above problems, but it may generate fees for some existing CCRC's that are simply too large to implement, in which case the open group would have to be employed.

Chairman HEINZ. Our next witness is David Cohen. Mr. Cohen spent, as I understand, 2½ years with the Robert Wood Johnson Foundation funded Wharton School study, and in 1980, he wrote a Law Review article on the legal regulation of continuing care retirement communities.

Mr. Cohen, I understand that you are going to testify concerning the status of Federal and State laws on life care and what, from your experience, you feel is needed, nowithstanding Mr. Winklevoss' most recent admonition, by way of effective regulation.

STATEMENT OF DAVID L. COHEN, ATTORNEY, BALLARD, SPAHR, ANDREWS & INGERSOLL, PHILADELPHIA, PA.

Mr. COHEN. Thank you, Mr. Chairman.

I also have a prepared statement that I would like to submit for the record.

Chairman HEINZ. Without objection.[1]

Mr. COHEN. And I will, therefore, restrict myself to some general comments here.

My first general comment is—and I do not think Howard and I disagree on this to any significant extent—is that we need legislative regulation in the continuing care industry. This is not an industry that can exist in a totally healthy status, completely free of regulation.

Now, when I say "we need regulation," I want to qualify who that "we" is, because I think it is important in structuring legislation to realize who it is that needs the regulatory assistance. In my view, three different groups or entities need legislative regulation.

The first and most obvious group is the residents of the communities themselves, who have made this substantial up-front investment that needs protection. The second group—and the need for some protection for this group has been dramatized by the recent bond default by Fiddlers' Woods in Philadelphia—are the bondholders and other investors, the people who provide the capital for these communities. Finally, the third group requiring protection from legislation is the communities themselves, because, as Howard says, there is some resistance to managing these communities as an actuarial business enterprise, which is precisely what they are.

Earlier today, Mr. Lewis pointed out to me something that I think is very interesting, and something that I always suspected, but never confirmed. It turns out that groups one and two of the people who need protection from legislation overlap to some extent, because Mr. Lewis told me that some of his residents actually hold bonds in Fiddlers' Woods. I have been told that it is relatively common for continuing care residents to purchase the bonds in continuing care retirement communities. Thus, we end up with the residents themselves being providers of capital for their own communities, as well as the providers of capital for other communities.

[1] See page 21.

I also want to emphasize that we don't need legislative regulation because every community is incapable of running itself. The overwhelming majority of communities will do just fine without legislation. Unfortunately, as you have seen again, one has to legislate for the least common denominator for the worst case. And when one keeps that focus in mind, there is a delicate balance that has to be struck in legislating in this field, because one cannot make legislation so burdensome and so intrusive that it is so expensive to comply with that good communities are actually financially threatened by the legislation that is designed to protect them.

The third general point I would make—and I recognize that I am taking my head in my hands as I say this—is that the primary regulation of the continuing care industry should be at the State level. As a lawyer I hate to say this, and I am sure that you hate to hear it even more as legislators, but I cannot tell you, and I do not think that anyone else can tell you, exactly what legislation regulating the continuing care industry should look like. We do not know yet, and for that reason——

Chairman HEINZ. By the way, sometimes we do not get that kind of honest advice.

Mr. COHEN. Well, if I can't give you a panacea, the least I can be is candid about my inability. But I think because of that difficulty, we need the diversity that a decentralized State/local-oriented approach to regulating the continuing care industry would provide.

Now, as I point out in my statement, that does not mean that there is no role for Congress to play. This hearing is immensely useful in drawing attention to the problems of the continuing care industry. In addition, Congress can pass at least two different types of legislation that would help States to act in when they should act. One type is what I call minimum standards legislation. For example, just about everyone is in agreement that financial disclosure to residents and prospective residents is a good idea. There would be nothing wrong with a Federal statute requiring such disclosure, and delegating administration to the States.

The other kind of Federal legislation I would consider useful would be what I call encouraging legislation, and I use that term only slightly sarcastically. My model for that would be, for example, what Congress has done with Federal highway funds and environmental standards. The Federal Highway Act provides that, unless the States implement environmental standards that meet certain levels, they stand to lose their Federal highway funding. Well, if the Congress were to legislate that, unless States enacted legislation in the continuing care arena meeting certain standards, or received a waiver from having to enact that legislation—because, for example, a certain State might not have any continuing care retirement communities—they would lose their medicaid funding or some other kind of funding, I suspect that that would go a long way toward encouraging States to enact appropriate legislation.

My fourth general point—and I will conclude with it—is that it is impossible for me to tell you exactly what components belong in an optimal legislative program regulating the continuing care industry. I have outlined various components in my prepared state-

ment, and in attachments to that statement, and I think that those are the areas that we should be examining. To summarize, they are: Certification of communities; regulation of financial status, including escrow requirements and reserve funds; legal regulation of relationships between the resident and the community, which would include disclosure requirements, advertising regulation, and form and content of the contract; and administrative provisions providing for ongoing monitoring of the continuing care industry and for intervention on the part of the State in the event a community falls below certain standards.

Thank you.

Chairman HEINZ. Mr. Cohen, thank you, and we will take a very careful look at your complete testimony.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF DAVID L. COHEN

Mr. Chairman and members of the committee, thank you for the invitation to testify before the Senate Special Committee on Aging on the subject of regulation of the continuing care (or life care) industry.

The problems of the continuing care industry raise complicated and unique regulatory issues that deserve the attention of the legislative and executive branches at both the Federal and State levels. Yet, because of our collective regulatory inexperience in this industry and the special dynamics of continuing care, the precise contours of appropriate legislation relating to the continuing care industry are unclear. Hearings such as this can be immensely useful in formulating effective regulatory responses to the problems of the continuing care industry. The committee, therefore, should be applauded for holding this hearing—the first congressional hearing ever on continuing care.

The job of evaluating all the components of a possible legislative program regulating the continuing care industry to determine which of them should be enacted, and in what form, is quite time consuming and difficult. It is this task that first attracted my attention in 1979 when I began my research on the continuing care industry. My interest in this subject has continued during my involvement with the Wharton School study on continuing care retirement communities over the past 2½ years, and in my law practice today.

This is obviously not the time or the place to attempt to identify or summarize in any comprehensive manner the particular kinds of language and provisions that should be contained in an optimal legislative program regulating continuing care retirement communities. Our time constraints make that an impossible task. Instead, I will make only limited comments, and have attached copies of my previous writings on this subject for the committee's reference. Attached hereto as exhibit A [1] is a copy of my article entitled "Continuing Care Retirement Communities for the Elderly: Potential Pitfalls and Proposed Regulation," which was published in the April 1980 issue of the University of Pennsylvania Law Review. Attached hereto as exhibits B [1] and C [1] are copies of chapters 12 and 13 of the Wharton School study, to be published this year. The article and chapter 12 present comprehensive narrative descriptions of the continuing care regulatory environment, while chapter 13 is a more normative analysis of what continuing care legislation should contain. In addition, I would be pleased to answer any specific questions that the committee may raise.

One preliminary consideration I would urge on any legislative body considering regulation of the continuing care industry involves the question whether any legislation is necessary at all. I have been a consistent advocate—both within and outside the industry—of the need for legislative action in the continuing care arena. Although I have heard many reputable arguments going to the extent and form of potential legislation, I do not believe that the general legislative inaction position commands any credibility today. This is not to say that every State is in need of legislation regulating the continuing care industry. Ten States already have such legislation and, according to the Wharton School study's survey, 19 States have no continuing care communities and 11 more have three or fewer. A complete State-by-

[1] Retained in committee files.

State breakdown of continuing care retirement communities is attached hereto as exhibit D.[1]

Of course, not every continuing care retirement community requires regulation. Most communities function quite well without regulation. Perhaps with the advent of meaningful self-accreditation programs, it will be possible for the overwhelming majority of the continuing care industry to perform in an exemplary fashion without the benefit of governmental involvement. As usual, however, it is the few bad apples with the potential to spoil the entire barrel that dictate the necessity of a legislative solution. Nor will legislation be a panacea to all of the continuing care industry's problems. As the Pacific Homes situation of a few years ago demonstrated, even comprehensive and enlightened legislation will not necessarily prevent the most feared result in the industry—default and bankruptcy of a community or chain of communities.

I suggest that, in determining the scope of legislation regulating the continuing care industry, it is important to determine whom such legislation should be designed to protect. My own resolution of this question is that legislation should be designed to insure the continued functioning of all existing and future continuing care retirement communities.

This goal will help protect (i) actual and potential residents of such communities (the most commonly cited class requiring governmental protection); (ii) the people and institutions providing the capital for the communities (a class, the recent Fiddler's Woods situation in Pennsylvania suggests needs some protection); and (iii) the operators of the communities themselves. The other important aspect of this focus is that regulation should not be so intrusive and burdensome that the cost of compliance itself endangers the stability of continuing care retirement communities.

An additional preliminary consideration is whether legislation should be enacted at the Federal or State level. It is my view that the primary responsibility for regulating continuing care retirement communities should be at the State level, and comprehensive regulatory legislation by Congress is, therefore, inappropriate.

Now, I recognize the heretical nature of these remarks given my present location, but there are at least two solid rationales supporting that position. First, the type of regulation I envision—with a great deal of detail and a comprehensive certification and monitoring program—at least requires State/local administration. Second, and most importantly, because continuing care retirement community legislation is still relatively new, and because the continuing care form itself varies from region to region, it would be advantageous to encourage the variety of legislative programs that would be developed at the decentralized State level.

This is not to say that the Federal Government has no role to play. Congress could enact what might be called "minimum standards" legislation, such as H.R. 4170, introduced in the 95th Congress by then Representative, now Senator Cohen, presently a member of this committee (attached hereto as exhibit E [1]). Or Congress could enact more comprehensive legislation, but allow States to opt out of the Federal program if they enact a sufficiently comprehensive legislative package of their own. Finally, Congress could pass so-called "encouraging" legislation, such as was under consideration a number of years ago in the seatbelt area, under which States would lose some sort of Federal funding unless they enacted satisfactory continuing care legislation.

Once the preliminary considerations are cleared away, the remaining issue involves the form and content of appropriate legislation regulating the continuing care industry. For a comprehensive discussion on this subject, I would respectfully refer the committee to exhibits A, B, and C.[1] In addition, I have attached as exhibit F [1] a copy of the most recent draft of the Pennsylvania Legislature's comprehensive statute regulating the continuing care industry. This bill is the product of several years of work by the Pennsylvania Senate and the continuing care industry in the Commonwealth of Pennsylvania. It represents a fairly good accommodation of the competing tensions that make legislation in this area so difficult. I can, however, give you a brief general overview of my thoughts on the proper form for continuing care legislation.

Although I think there can be a great deal of flexibility and diversity in legislation regulating the continuing care industry, every statute should contain four minimum components: (i) A comprehensive certification/accreditation program for both new and existing continuing care retirement communities; (ii) financial regulation of continuing care retirement communities, including escrow and reserve fund provisions; (iii) legal regulation of resident relationships with the community, including financial disclosure, regulation of the form and content of the continuing care con-

[1] Retained in committee files.

tract, and advertising regulation; and (iv) comprehensive provisions to monitor continuing care retirement communities and administer the statute.

Although these comments have been fairly general, I hope that my presentation has been of some help to the committee. Thank you again for your invitation and your interest in this important area.

Chairman HEINZ. Our next witness is Lloyd Lewis, who also participated in the Johnson Foundation-Wharton School study. Mr. Lewis is the executive director of Kendal-Crosslands, a nonprofit corporation which operates two continuing care communities in Pennsylvania.

Mr. Lewis, I understand that you are going to give us some insights as a provider in the field of continuing care.

STATEMENT OF LLOYD W. LEWIS, EXECUTIVE DIRECTOR, KENDAL-CROSSLANDS, KENNETT SQUARE, PA.

Mr. LEWIS. Thank you, Senator. I hope I can do that.

I do have a prepared statement, which I have submitted, and I hope that you will bear with me if I read substantially the whole thing.

Chairman HEINZ. As long as it does not go much past 5 minutes, we will bear with you as long as it takes.

Mr. LEWIS. All right. My name is Lloyd Lewis. I am executive director of Kendal-Crosslands, a nonprofit corporation whose board of directors is made up of members of the Religious Society of Friends, Quakers. We operate two communities in Kennett Square, Pa., serving the needs of approximately 725 older people. We provide employment to a staff of 500 full- and part-time employees. Kendal at Longwood, our first community, has been in operation since October 1973, and Crosslands has been open since September 1977.

We are members of the Pennsylvania Association of Nonprofit Homes for the Aging, an organization of over 200 nonprofit agencies serving 29,500 older Pennsylvanians, providing employment to over 15,000 people. We have approximately 40 continuing care facilities in our State. I serve on the board of directors of this association.

We are also members of the American Association of Homes for the Aging of Washington, which represents over 2,000 national nonprofit organizations that serve 500,000 older Americans. We have approximately 300 continuing care facilities in our membership. I serve on the house of delegates, AAHA's governing body.

The continuing care community industry has exhibited dramatic growth in the past decade so that there are now almost 400 such communities in the United States with many more planned. Older people considering the continuing care alternative are basically interested in the high quality of life and quality of care afforded in such communities. Financial security, independence, sociability, physical safety, and a specially designed atmosphere are important ingredients of that high quality of life. The basic elements contributing to the high quality of care include continuity, controlled and shared costs, and minimization of losses, both physical and emotional.

My view is hardly objective, but as a professional in the field, I feel comfortable in saying that the best things in nursing or long-

term care in the United States today are happening in continuing care communities. The opportunities for study, research, and innovation in care abound and while perhaps not ideal from all points of view, the continuing care approach is worthy of favorable support by all elements in our society.

Most of the successful communities in the United States have developed long waiting lists for the future, and while faced with many problems, the communities are flourishing. Basically, we are serving the middle-class segment of older America. The individual or couple who has enjoyed favorable employment in life, having social security, a pension, and perhaps some savings, and who own their own home, generally find they can afford to live in such a community. In fact, the socialization of costs, spreading the risk of costly nursing care over the whole group living in a community, often preserve a financial estate, and serves society in general by keeping them off the medicaid rolls.

Little formal study of demographics regarding who lives in continuing care communities has been carried out. My own observation has been that the most common former vocation represented in a community is that of teacher, then librarian, social worker, nurse, and physician. People who have been good planners all their lives and who have been in human service vocations involving frequent contact with people in a cooperative and supportive environment, find the transition to life in a continuing care community easiest and most rewarding.

Again, little formal research has been carried out, but there are strong indications that living in such a community adds years to one's life, in quality as well as numbers, and involves lower dollar cost than other alternatives to the individual and society. While formal studies have not been carried out, it is strongly indicated that individuals living in continuing care communities spend less time in acute care settings than the average older American and use fewer medications with better results.

In general, I have found that people living in an individual community are staunch advocates of that community and their life in it. Indeed, they are the best sales or marketing people I know of in the field, as are their families. For Kendal-Crosslands, after 10 years, we are finding an increasing number of children, second generation, on our waiting list for the future. Our waiting list for 475 residential units now numbers over 900.

But what are the features about our communities that are most favorable? They are a sharing of the high costs involved in long-term care, so the burden is spread out over the entire resident group; a high quality of social and cultural life; financial and physical security; and a quality of care that few could afford or find individually.

On the other hand, we are not an industry without problems. First, we struggle with the general issue of "ageism" that permeates our society. Second, social and medical research in the field of aging is still in its infancy. Third, education in gerontology and geriatrics has only just begun, so we have a relatively small cadre of trained professionals to meet the needs of a burgeoning elderly population. Fourth is the entry of all kinds of opportunists seeking to exploit the growing market. Fifth, access to capital by the most

qualified group, the nonprofit sector, is limited and faulted. Sixth, consumer education is a neglected area; not much material other than that developed by American Association of Homes for the Aging is available.

I will not try to address all these problem areas I mentioned, but I would like to comment on the last three. The influx of "instant experts," consultants, and opportunists into the field has been a tremendous problem. Misinformation and misconceptions about serving the aging abound, and people seeking to exploit the economic opportunities that seem to be there have caused havoc in recent years. We have always had a certain number of charlatans in the field, as all areas of endeavor have, and we have always had a certain number of inept or incompetent practitioners who have made a "loud mess" of projects from time to time. But now we have "instant experts" who think the answers are easy, and who seize the opportunity to go for big dollars. The weakness of many of our nonprofit laws in many States has encouraged unscrupulous but ingenious operators to plunge in. Other adventurers have exploited the use of tax-exempt industrial development bonds to generate high fees for themselves, but have resulted in otherwise poor and ill-conceived projects.

Now we have to worry that the abuses or excesses of the last few years by adventurers may result in closing some of the most important sources of capital that a growing nonprofit industry needs. Without access to capital, the nonprofit group will have difficulty competing with well-funded proprietary interests who may seek to enter the field on a large scale. Should proprietary interests succeed on any scale in entering the field, it will probably be to the detriment of the industry. If successful, they might well drain off the more financially able segment of our older population, widening the gap between the "haves" and the "have nots."

Perhaps I am best qualified to speak on the issue of consumer education. As a practitioner or provider, I have come to know how few people looking to enter a continuing care facility ask the right questions. Rarely am I asked penetrating questions about our finances, nonprofit status, or overall approach to the subject of aging. Even more rarely am I asked searching questions about our health care facilities and programs. In our own case, we have always taken an aggressive attitude toward developing excellence in care. Thus, we do not segregate or confine confused and frail residents. We do not own restraints, so that we have never used mechanical or physical restraints on a patient in our health center. These are critical points in the care of aged people, and yet we are only occasionally asked questions about our most intimate and important services.

The American Association of Homes for the Aging is a pioneer in consumer education and a strong advocate for rights of the elderly. To this end, in 1977, they published "Continuing Care Homes: A Guidebook for Consumers." And in 1980, they published "Continuing Care: Issues for Nonprofit Providers." In preparation today is a free consumer brochure covering major issues for today.

Now, in cooperation with the American Association for Retired People, the American Association of Homes for the Aging will publish a new "Directory of Continuing Care Communities in the

United States," providing data on over 400 communities. Funding for the initial publication of this directory comes from a grant by the Commonwealth Fund. This publication has the potential of becoming the single most important consumer educational and information piece in the United States today.

In addition, with the encouragement and support of our various State associations, as well as the American Association of Homes for the Aging, a group of Delaware Valley continuing care communities is developing an accreditation or peer review process that we hope will eventually be used throughout the Nation. Our objective is to encourage the development of a healthy industry through the establishment of high standards and practices. We further hope that such an accreditation program will help to discourage those who would seek to exploit this industry for purely personal gain, or through ignorance, might inadvertently design and build faulty institutions.

We believe that further research may well establish that continuing care, from a cost standpoint, may be very much in the public interest. If this is so, government can do much to encourage the further growth of the industry and help it to reach a broader economic spectrum of our older population. For example, if medicare and medicaid dollars might be saved by the wider use of continuing care mode, every 202, section 8 project in the United States is a potential community through the addition of a health care—medical and nursing—unit.

I have just touched upon what I consider to be the most important positive and negative aspects of our industry. I stand ready and available to answer questions and pursue any further avenue.

Chairman HEINZ. Mr. Lewis, thank you very much.

Our last witness on this panel is Judge Thomas Jenkins, judge of the Superior Court of San Mateo, Calif. He has had extensive experience with the development of regulation of life care facilities in California. California, it should be noted, was the first State to enact life care regulation.

Judge Jenkins has been a member of the research project committee, and I understand, will discuss the California experience with life care.

Judge Jenkins, welcome.

STATEMENT OF HON. THOMAS M. JENKINS, REDWOOD, CALIF., JUDGE, SUPERIOR COURT, STATE OF CALIFORNIA

Judge JENKINS. Thank you, Senator.

I, too, have a written statement which I would like to file. Much encompassed in that has already been covered by other speakers today.

Chairman HEINZ. Without objection, the entire statement will be part of the record.[1]

Judge JENKINS. I would like, then, to make simply a few brief comments.

Particularly, I am interested in the atmosphere in which this entire discussion continues. Mr. Holton indicated to me, in the be-

[1] See page 28.

ginning, about this being a new concept with which there are many problems. It is really not that new a concept. We have had it for over 50 years in California. It is a concept which, as Mr. Ball has indicated, gives promise for an extraordinarily viable alternative lifestyle.

I would suggest to you that there are only three sources of funds available for housing and care for the elderly, as any other segment of our society. That is, philanthropic, governmental, or payment for services and care by those who are receiving that care.

Governmental aid, I do not anticipate, and I suspect that no one else in this room anticipates, will increase the service to elderly, at least to the extent that perhaps many would like to have it increased. It has not, in fact, been a major source of funding for housing needs nor for health care needs of the great segment of our society that we are talking about, who are the middle class.

Philanthropy is also not really available as a source of funding. It has been my privilege to be involved for some 25 or 30 years in a variety of volunteer organizations. I have served as president of the United Way of San Francisco, United Way of California, and a variety of other organizations. There are over 400,000 voluntary agencies seeking the philanthropic dollars, with people identified with a variety of demands and needs. The aging are not, again, going to be able to take a disproportionate share, particularly for housing, and thus, we have left only, it seems to me, this concept of people who have fiscal resources being able to work together in order to be able to accomplish something toward meeting those needs. The fact that they have fiscal resources does not obviate the need for housing, the need for care, the need for living together with decency and dignity in the remaining years of their lives.

Having said that, then, I would comment that I am concerned with the possibility of approaching this in an adversary way. I have spent some 30 years, more than 30 years, as a lawyer and judge. I happen to be one of those who feel that many problems ought to be resolved outside the court system, and that I am not necessarily, as a judge, omnipotent, and able to resolve everything.

I find that we have litigation consistently where we are asked to make decisions on legislation which, as Mr. Cohen indicated, along with a lot of other legislation, is good for lawyers, good for judges, good for actuaries, Howard hopes, good for accountants, but is not necessarily good for those who are the ones primarily involved, the people who are being served.

So, having been involved for some 30 years in California in the legal process, I agree that we are under legislative control. I am again not one of those who disagrees with regulation. I think regulation is important and imperative. But a note of caution. I do not think that Federal legislation, except perhaps, of the kind that Mr. Cohen indicated, is appropriate. Now Senator, former Congressman Cohen, started to involve the Congress in legislation back in 1977, and there were numerous discussions at that time. It was concluded that primarily, Federal legislation may well become punitive in nature, may involve the Federal courts and district attorneys, may result in jail for someone, but essentially does not protect the people who wish to and need to be protected.

Most of the problems we have are problems of bad management, lack of information; very few involve fraud. A comment was made at the beginning about scores of our facilities that are now bankrupt. I am not aware that there are scores. There are relatively few, to my knowledge. We have problems such as those at Pacific Homes. Given the opportunity, I will be prepared to go into that in more detail.

Chairman HEINZ. You will be.

Judge JENKINS. All right. Then, with that knowledge, I would then simply state that I encourage this as a concept. I think there is real validity to this. I think there is a need for disclosure of the kind that Mr. Lewis talked about. The work of the American Association of Homes for the Aging is paramount in this field, with its consumer guide and informational documents. I do not think there is validity to singling out this industry above all others and suggest that there is no need for punitive legislation when what we want to do is to encourage the concept.

Chairman HEINZ. Thank you very much, Judge Jenkins.

[The prepared statement of Judge Jenkins follows:]

PREPARED STATEMENT OF JUDGE THOMAS M. JENKINS

Mr. Chairman and members of the committee, I am Thomas M. Jenkins, judge of the Superior Court, State of California. I am past president of the American Association of Homes for the Aging, a cofounder of the California Association of Homes for the Aging, recent chairman and member of the board of Northern California Presbyterian Homes. Other activities have included the presidency of the United Way of California, president of the United Way of San Francisco, national vice chairman of Campfire Girls, member of the Judicial Council of California, governing board of the California Judges Association, and the State Bar of California. My primary concern for over 25 years has been in the care of the elderly with particular emphasis in the area of your consideration today—"life care," or in more modern terms "continuing care."

This Senate committee is very well aware of the demographics of the aging, the increase to in excess of 30 million in the "over 65" group in the near future, and the history of housing and services to that segment of our society. In earlier times, the elderly resided in the "alms house" of Dickens, the "county poor farm," the "old folks home." Living in such establishments need not be detailed. Vivid descriptions of their squalor and the lack of care and neglect of the aged have been portrayed many times. These were "custodial" institutions, usually government operated.

Commencing in the late 19th century and continuing today, nonprofit associations, principally religious, became involved and active in carrying out that perhaps too often repeated articulation by De Tocqueville (Journeys in America, 1837): "* * * I have often admired the extreme skill with which the inhabitants of the United States succeed in proposing a common object for the exertions of a great many men and in inducing them to voluntarily pursue it."

Thus, thousands of leading citizens in American communities have sought new and varied ways to meet the requirements of the elderly. Two concepts have assisted in guiding their endeavors. First, the elderly are not a monolithic group having the same characteristic, wants, and needs, at any given time. Today, in fact, older persons are an increasingly aware, better educated, much more articulate part of the whole body politic. They vary from the well to the frail, the old to the old-old, stevedore to corporate president, housewife to executive, impecunious to very wealthy.

Second, all have a need for housing, all have a need for medical care, all have the need and should be given the opportunity to enjoy their older years in dignity and decent surroundings.

From this a variety of living arrangements, culminating in retirement facilities with the spectrum of care from independent living to skilled nursing has evolved to meet those needs. Obviously, that requires ever increasing financial resources.

Funding for capital and service can come from only three sources—philanthropy, government, payment by those who receive service. The demand upon the philanthropic dollar has increased enormously in recent years. Happily, the public is responding, with ever increasing dollars. But today there are over 100,000 voluntary

agencies in the United States seeking contributions for a wide variety of causes. The disabled, minorities, economically deprived, religious, and cultural groups all have their special need and special support, particularly in this era of recession and unemployment. The amount which can be obtained for the aging is minute, and although increasing effort will be made to secure it, funds needed, particularly capital costs, will never be available from that sector.

Government has made a massive infusion of funds into the health care field, particularly since medicare in the mid-1960's. That immense impact on the gross national product is a major part of the struggle for solution going on today in this Congress and in the administration as the budget is being considered. But with respect to the housing of the great bulk of seniors, such governmental aid has never been furnished. Relatively small sums have been utilized for facilities under the National Housing Act. Section 8, housing subsidies, provide for some. A variety of other programs such as those under the Older Americans Act are of aid. The total sum is, in context, again small. And no one predicts that significantly more funding will be available for older Americans.

Thus, the third source of funds—payment by those being served, assumes major proportions. Social and fiscal patterns over the past 30 years have changed markedly. Increases in social security and private pensions, personal investments, provide more adequate funding for daily living. Now, and for the next two decades, a surprisingly large proportion of those over 65 do and will own their own homes. Many are mortgage free. In certain areas, such as California, inflation has greatly increased their capital asset value.

This has resulted in many more persons who are able to contribute most, if not all, of both the capital and operating costs of their care.

Those factors are utilized through the relatively new method of financing, evolving since the 1920's, of "life care" or "continuing care." Payments of an entrance fee (founder's fee, capital sharing fee) together with monthly payments by residents is now a major source of funds for new homes throughout the country. Today, such funds are the principal means of raising equity capital for new construction and amortization of debt. Various funding mechanisms such as private institutional loans, loan guarantees, private and governmental revenue bonds are developing. In this way, literally hundreds of millions of dollars of private capital are being put into this field, by those being served. There they can, and do remain vigorous, contributing, and useful members of our society, in their own "home." This permits persons who have some means to make payments for entry into a facility which sum is irrevocably dedicated to the field of the care of the aging. By this means those who are being served have found essentially the only nontax resource available today for the construction and operation of such entities.

And I come before this committee today to enlist your support, your enthusiasm, your encouragement of this concept. Tens of thousands of the elderly are being served. Many thousands more are on waiting lists. In the San Francisco Presbyterian Homes where I serve, 4 to 5 years before entrance is the norm. It is longer in other areas. I solicit your discussion with residents, their joy in their new lifestyle, the increased level of care, their longer life, their opportunities to lead a fuller life. We have a large, ever increasing over-65 population element in our society, many in relatively comfortable fiscal circumstances. Great potential exists for services to them, and by creative concepts to less economically able. (This is being done, and given time I would be pleased to give details.) Any review of these communities reveals a positive, well accepted and most appreciated program by those presently served.

This hearing is called because of your interest—and because you have become aware of certain problems. There has been some overreaching. There have been some bankruptcies. But to suggest that they are of such proportions as require punitive regulation, as some do, is to emphasize the difficulties in a very small number of projects, in a very few instances in a few States, and do great disservice to the possibility of positive programs in the voluntary sector, for the many.

Does this mean that only free market competition should govern—the old concept of "let the buyer beware"? No. My entire background in the law and the judiciary as well as over 25 years in this field belies that. Since an especially vulnerable age group, committing large parts of their assets, may be involved, various safeguards must be considered above such a system. What do I suggest?

First, the least governmental intrusion possible should be utilized. There are many laws on the books of every State that cover cases of fraud and criminal acts. These can and should be used in those relatively rare instances where necessary.

Second, Federal regulation is not appropriate. Any in-depth study must conclude that it is uniquely unsuitable. It can only be essentially punitive in nature. Earlier

suggestions had included prosecution by U.S. attorneys in the Federal district courts. This is a burdensome process, may result in some imprisonment, but really does nothing to protect those with whom we are concerned. It cannot substitute for local administration and supervision, it is apt to evolve a new series of bureaucratic regulations far removed from reality, onerous and time-consuming in practice, and act to prevent, rather then encourage badly needed additional facilities and services.

Third, only at the State level can regulation be effective. Here a note of caution. As one involved in, active in drafting, supportive of, and living comfortable under probably the most restrictive regulatory scheme in the Nation, that in California, I urge a slow approach. Many have looked at mandatory regulations. Many have postulated their preference for all encompassing protective provisions. But many have also recognized that suggested and existing regulations, theoretically proper and palatable, cover only assumed abuse. They do not in fact assure financial stability and do not prevent some of the situations which have given rise to question.

It must be recognized that in fact many of the problems arise from lack of business judgment and management expertise by well-intentioned, intensely concerned persons who have dedicated their lives to the care of the elderly. An example is the Pacific Homes case in southern California, of which I've had considerable knowledge for over 20 years. Their story is not that fragmentary rendition by "60 Minutes," but is a compendium of extraordinarily good intentions, lack of financial knowledge, bad advice, and bureaucratic blundering. Solutions to their difficulties were available under existing regulations and conditions. Resort to courts and litigation were both costly, time-consuming and, in my opinion, unnecessary. Again, if time permitted, much more detail could be given. But I repeat that highly detailed legislation is not the answer.

Fourth, extensive and ongoing financial disclosure, to prospective applicants and to residents is the most significant and helpful action that can be taken. The proposals of the American Association of Homes for the Aging for consumer guides and for State disclosure provisions (separately presented to you) are a positive approach with great merit. If there is a free and open exchange of information, many of the problems being discussed will not occur.

Fifth, escrow provisions for new communities should be considered. They should not be as restrictive as those in California. With the advent of bonding mechanisms, the financial institutions involved in those transactions generally set up protections which are more extensive and mitigate against the governmental requirement for specific regulations.

Sixth, reserve funds requirements may continue to be considered at the State level, but accurate pricing mechanisms over a period of time may make them unnecessary. One of the tools suggested by others today, actuarial evaluations, gives promise of considerable potential to those making pricing determinations.

Seventh, certification and registration procedures to assist in assuring financial stability and in retaining standards of care, can be productive, at the State level.

To conclude, and not coin a phrase, this concept is the "wave of the future" for many thousands of your fellow citizens and perhaps for many in this room. Their protection is most important. But it is much more a matter of guiding those who render service, and insuring continuation of that service on a fair and equitable basis. I urge continued support by this committee.

Chairman HEINZ. Before I ask all of you a number of questions, I must say that one of the striking features of the continuing life care concept is, as many of you suggested, that it is a novel, far-reaching form of insurance. It is a combination not of one, but of many kinds of insurance. It combines health insurance; it combines long-term care insurance. Other than medicaid, there is no Federal Government policy on long-term care. And it provides for residential insurance—the three combined. And I suppose you could also add some social service insurance and a number of other, rather intriguing aspects. This is a remarkable concept, and when it operates well, it operates remarkably well.

We will hear from the next panel some instances of when it did not operate so very well—indeed, operated extremely badly. And it is certainly this Senator's hope that for all time, there will be a barrel full of red, ripe, healthy apples here, and that there will be very few, if any, spoiled apples, and we want to do everything we

can to encourage having lots of barrels, as well as good apples in them, Judge Jenkins.

I would like to start off by asking Ms. Schwartz, as a very unique person yourself, who got into this through geriatrics—I understand you are still a part-time geriatrics nurse—you are particularly knowledgeable in this area. Do the residents of your life care community, or you yourself, for that matter, become involved, or do you even have the opportunity to become involved in any of the decisionmaking that takes place at your life care facility, or is that strictly a management function that excludes the residents?

Ms. SCHWARTZ. Decisionmaking which has to do with resident life is very, very much in the hands of residents. That is, we have a strong residents' association which is extremely active; the joint council, which meets with administration on an advisory basis, and really a good deal of input but not any decisionmaking on those things which have to do with such policies as admission, investments, expansion of the plant—those are administrative, and in the hands of a voluntary board of, I think, 17 members, who represent a very diversified group of backgrounds and who plan in behalf of both the corporation and those of us who live there, very well indeed.

Chairman HEINZ. You described it as a very supportive and active place to live. You clearly are very satisfied with it.

Ms. SCHWARTZ. I am very enthusiastic about it, and I think most of our residents are.

Chairman HEINZ. To what extent, before you became a resident of this life care community, did you check into it? To what extent did you really give it the once-over, and did you make some very conscious judgments about how good it was, as not only a place to live, but how well-managed it was? You put up some money at the outset, and I assume that you wanted to be careful about it.

Ms. SCHWARTZ. I think I went into it as carefully as I was able to do, because I am more knowledgeable about health care and living of older people than I am, really, skilled in financial management. I think that it was the quality of life and the caliber of the health care that I was best informed on. I had read the financial statement and contract carefully, but I am not knowledgeable in analyzing financial statements.

Chairman HEINZ. So if I may read into what you just said, you were not able to evaluate the actuarial soundness of the management. You probably looked at the board and said, "These look like good people."

Ms. SCHWARTZ. To a certain degree, that was on faith, because of the quality of the people who made up the board, which I did indeed investigate.

Chairman HEINZ. That is the way most people do it, rightly or wrongly, and in your case, you did it rightly.

Ms. SCHWARTZ. I also talked to my lawyer, who went over all of the materials, both the contract and the published materials of the organization.

Chairman HEINZ. You appear to be one of a growing number of the pioneers described a moment ago. There are a very significant number of Americans who are financially eligible to participate in life care, can afford to enter a life care community.

Bob, I would like you to elaborate on the following point—and I want to welcome Senator Glenn, the ranking member of this committee; John, we are delighted you are here.

Senator GLENN. Thank you, Mr. Chairman.

Chairman HEINZ. Do you have an opening statement?

Senator GLENN. I have a statement for the record, Mr. Chairman. I will not take up the time of the committee, and I apologize for being late. We are in the traditional posture of having too many meetings all at the same time. So I am sorry I am a little bit late. But I do have an opening statement that I would like to have included in the record.

Chairman HEINZ. Without objection, so ordered.

Senator GLENN. Thank you.

[The statement of Senator Glenn follows:]

STATEMENT OF SENATOR JOHN GLENN

I am pleased to participate in this hearing, "Life Care Communities: Promises and Problems." During this hearing, we will receive testimony from experts in the life care field and learn why this is such a rapidly growing industry. We will discuss the great potential that life care communities offer to many middle-class elderly Americans seeking comprehensive care. We will also discuss the potential pitfalls of life care communities and examine the reasons behind the bankruptcies that have occurred in life care homes, dealing a devastating financial blow to their elderly residents.

Life care refers to a concept whereby an older person contracts with a life care facility to receive housing, nursing care, meals, and other specified services for the rest of his/her life. The most common financing arrangement requires the older person to pay an entrance or "endowment fee" and a monthly "service fee." Endowment fees typically range from $15,000 to $65,000 and even reach $100,000 depending on the size and nature of the living unit. Monthly service fees range from $300 to $900 per month and are roughly comparable to apartment rents or maintenance charges. The housing, services, and nursing care are usually provided at a single complex containing numerous living units in a campus-type setting. There are at least 300 to 500 life care facilities in operation today with about 100,000 residents. Revenues are projected to be approximately $1 billion per year.

Life care communities are attractive to many elderly persons because they offer the security of knowing that housing, meals, nursing care, and other necessary services will always be available. Life care offers a form of social insurance to the elderly—it preserves residential independence and removes the fear of costly long-term institutionalization. In well-managed life care homes, residents can cease to worry about how they will obtain the services they need if, in the future, they become disabled or infirm and need personal assistance or other types of long-term care.

I have a longstanding interest in life care communities and first requested the Senate Committee on Aging to examine this issue several years ago. The State of Ohio has many successful life care homes serving satisfied elderly residents. But I have also heard from constituents about the poor or questionable business practices of some life care homes. In 1979, the Ohio Nursing Home Commission, which was established by the Ohio General Assembly to conduct a 2-year study of all types of retirement homes, including life care communities, issued its final report. The commission and other experts identified several problems with life care communities, and offered recommendations for regulatory action to the State legislature. To date, these recommendations have not been acted on, and Ohio does not have any laws regarding life care communities. In fact, only 11 States do have such laws.

One of the major causes of bankruptcies in life care projects has been poor financial planning. While the actions of the sponsoring agency may be well-intentioned, some sponsors have lacked the financial, actuarial, and business skills to manage a project soundly. For example, incorrect life expectancy projections, underestimated inflation rates, and lack of long-term planning can lead to financial disaster. Sound management and accurate projections are essential to the successful operation of life care communities.

Many life care projects have run into financial trouble through the unwise use of their endowment fees, which range from $15,000 to $100,000. Using these fees for capital building projects is a relatively safe, interest-free way of developing or ex-

panding a capital program. Also, escrowing the entire amount and amortizing it over a specified period of time for future operating expenses is suitable. However, if funds that are earmarked for use in the future, when an elderly resident may need extensive nursing care, are used instead for current operating expenses, the facility is courting financial disaster.

Another area of concern is in advertising and contract arrangements for life care communities. Many life care projects are related to a church and use the name of the church in their title or brochures. When this is done, the financial and supervisory responsibility of the church should also be made clear. In some cases, such as the bankruptcy of the Pacific Homes projects in California, the Methodist Church had no financial or legal ties to the life care projects despite heavy advertising that the life care homes were backed by the church.

It is essential for all life care projects to give complete and open disclosure of services, financial conditions, and ownership so that a prospective resident can determine whether or not a facility is financially sound. Signing a life care contract is a major economic and social decision. A prospective resident should seek qualified advice from the family lawyer, accountant, or financial adviser. Yet some elderly persons or their counsels have been refused access to financial statements of life care communities.

I was pleased to review the manual for life care providers published by the American Association of Homes for the Aging (AAHA) which includes guidelines for proper disclosure and advertising practices. The association agrees that basic ethical, legal, and financial practices can be established without imposing a burden on any fairly run and reputable life care home.

Today's hearing is the first congressional hearing on the subject of life care. I look forward to receiving testimony from Howard Winklevoss, Robert Ball, and other members of a study commission on life care communities sponsored by the Robert Wood Johnson Foundation and undertaken by the Wharton School of the University of Pennsylvania. This comprehensive study will be extremely helpful because hard data on the fast-growing life care industry is scarce. The study represents the first empirical, financial, and legal analysis of life care communities, and it provides recommendations for legislative action. I also look forward to hearing from a life care resident, and from Federal and State officials who have investigated life care communities.

Life care communities have much to offer to the growing number of elderly persons who are searching for security in later life. We should encourage the continued growth and development of financially sound and legitimate life care communities. We must also determine what action is needed on the Federal, State, and local levels to protect the hard-earned investments of elderly Americans by preventing fraud, abuse, and mismanagement in the industry.

Chairman HEINZ. Bob, is it your view that while there may be a very large number of Americans who could participate in life care communities, that those who are exclusively dependent on social security benefits, which is a substantial and growing number, might have difficulty in entering a life care facility because it would turn out to be too expensive, or because the monthly payments might not track the increases in social security benefits.

Mr. BALL. Mr. Chairman, I think it is unlikely that very many people who are solely dependent on social security would, in the near future, be candidates for continuing care retirement communities. A high proportion of them would probably be able to have the downpayment as a result of selling their homes. There is an astounding amount of homeownership among older people. About 73 percent of the people over 65 own their own homes, and probably 90 percent of the housing stock that is owned by older people is actually equity. Eighty percent have no mortgage at all, and the others have paid a great deal on the mortgage. Actually, the average amount shown in the 1980 housing survey was close to $50,000 in equity, and I am sure it is over that now.

But the monthly fees are a problem. Social security, of course, has the tremendous advantage of keeping up to date with inflation,

so that if the home is well operated and actuarially sound, and the increase in the monthly fees is close to the general rate of inflation, the indexed social security benefit is a tremendous help. However, you would have to be pretty close to a maximum beneficiary if that were your sole source of income in order to consider a CCRC. The maximum for a couple now on social security runs about $1,100 a month, and that does not leave much margin above the monthly fee.

So I would guess that the group that you should be thinking about—first of all, this is attractive mostly for over 75-year-olds so far—and I think the group you would be thinking about are those who, in addition to social security, have some sort of supplementary pension plan, either a private plan, a State, local, or Federal plan. Liquid savings do not turn out to be terribly important as a source of regular income for most retired people. Their savings are mostly locked up in housing. So that the continuing income would seem to come primarily from a combination of social security and supplementary pensions, leading to what Mr. Lewis was saying, that at least so far, the residents tend to come from a group of people who do have supplementary pensions in addition to social security—such as teachers, social workers, business people, and so on.

Chairman HEINZ. What proportion of our senior population would you say could: One, afford life care, and two, be in some sense, well suited to it?

Mr. BALL. Mr. Chairman, I really am not able to give you a good answer to that. You have to take into account in estimating who can afford it, the fact that the monthly fee will be increasing. It is not just whether there is enough money at the time the individual becomes a resident, but there needs to be, I should think, from combined social security and non-social security sources, monthly income probably twice as large as the current fee in order to guard against future increases. That leads me to think that, although there are certainly many, many times the number who could afford such commodities compared to those who are residents, more in the direction of 15 or 20 percent of the population over 75 rather than the 60 percent that is sometimes talked about. It isn't just the wealthy, certainly, but on the other hand, this is not a program for the poor, the near-poor, or even low-income people. But that, to my mind, does not make it unimportant. I think we need alternatives, too, for people who have somewhat above average incomes.

Chairman HEINZ. But 20 percent of people over age 65 is a very large number.

Mr. BALL. Oh, yes, indeed.

Chairman HEINZ. It is millions of people. There are only about 100,000 people in life care communities now, so the potential for life care is magnitudes larger than its present use.

Mr. BALL. I believe so, Mr. Chairman. Then comes the question of personal taste and alternatives. Who wants to do it. And then there is the question of availability. Right now, as has been testified to, there just are not the places.

Chairman HEINZ. I am advised that there are about 10 million people age 75 and over in the country today. If you just took 20 percent of that, that would be 2 million people, which would be a

remarkable number of people to be served by this new form of insurance.

Mr. BALL. It would, when you consider only 100,000 now have it.

Chairman HEINZ. That is right.

I want to ask Dr. Winklevoss—well, before I do, let me ask Bob Ball, because I know Bob has an 11 a.m. deadline, and I want to be sure I ask him this one last question.

Would you generally agree with the suggestions by Mr. Cohen and, for that matter, Judge Jenkins, that the basic emphasis here should be State regulation and that the Federal Government should not intrude with heavy hands in this area?

Mr. BALL. Certainly, I agree, Mr. Chairman, at this time. I agree with the idea that we do not know enough at this point. I am not even sure we know enough to follow the encouragement role that Mr. Cohen was speaking of very far, because if the Federal Government is going to say that unless a State passes a law with certain minimum requirements, there will be a marching-in arrangement, you have to know what those minimum requirements should be. If they are minimal, we are prepared to do that, but not more for now. I hesitate a little, on the other hand, to rule the Federal Government out of the field for all time.

Chairman HEINZ. Bob, don't worry. No one has figured out how to rule the Federal Government out for all time, no matter how desirable it may or may not be.

Mr. BALL. It certainly, I think, is not the way to go now, and it is very important at the State level, in my view. I agree completely with Judge Jenkins, that if it is not done very carefully, important as regulation is, it can actually slow down and interfere with sound growth.

Chairman HEINZ. I want to ask Dr. Winklevoss, there may be as many as one-half of the life care facilities that seek additional reimbursement from the Federal-State medicaid program. Doesn't seeking third-party reimbursement, especially through a means-tested program like medicaid, essentially defeat the purpose of the life care community as a self-contained insurance pool?

Dr. WINKLEVOSS. Well, I do not know that I would say it defeats the purpose of it. From the operators' point of view, if there are funds available through medicaid, you would probably want to take advantage of those funds.

But I think more importantly is the notion that, philosophically, I do not know how you can allow a person to pay a $50,000 entry fee into a CCRC and then run out of money and become eligible for medicaid. It just seems to me that is not the spirit of that legislation. And although if I were an operator, I would attempt to receive funds in all the directions I could legally do so, I think there is a philosophical gap in that capability that should be not permitted.

Chairman HEINZ. One thing the Federal Government could do is say that medicaid cannot reimburse life care facilities. Would that be a good or a bad idea?

I see Bob Ball creeping up to his microphone.

Dr. WINKLEVOSS. It would aggravate the financial situation that some communities face, but it seems to me that—I have to speak

for the country as a whole and the taxpayers as a whole—that is a good idea.

Chairman HEINZ. Well, Mr. Lewis said in his statement that one of the very important contributions that life care makes is to keep people—he said it on page 2 of his statement, as I remember—to keep people off medicaid. Obviously, you cannot keep them off medicaid if the facility puts them on.

Mr. Cohen.

Mr. COHEN. I wanted to point out something that might be of some interest to you. At least three States have actually passed legislation or promulgated regulations doing precisely what you have suggested, that is, making residents of continuing care retirement communities ineligible for medicaid assistance, in most situations. Those efforts are discussed in some of the attachments [1] to my prepared statement.

Ironically, these State statutes and regulations are legally suspect. One similar statute was struck down by a Federal court in Connecticut, which held that the general congressional statement in the medicaid statute to the effect that all medicaid eligibility determinations must be based on actual need, overrode the State legislation.

Chairman HEINZ. What State was that, because I think California is one of the two States.

Mr. COHEN. The States of which I am aware are Connecticut, Illinois, and New York. The case was *Buckner* v. *Maher,* and that is cited and discussed in my Law Review article. But I think it is ironic that the Federal Government is actually in a position now where it is the "heavy" on this issue.

Chairman HEINZ. Let me ask Dr. Winklevoss one more question. When you look at the prospectus of one of these communities such as the one that recently got in trouble in Philadelphia, operated by Fiddlers' Woods—in your judgment, how easy is it for a sophisticated investor—you are told in all those prospectuses that you had better be a sophisticated investor—to judge the financial solvency of a life care community. What about a resident who is going into the home?

Dr. WINKLEVOSS. Well, maybe I could answer that by saying that I consider myself to be fairly knowledgeable of the financial aspects of CCRC's, and I would have no way of deciding from the prospectuses that I have seen whether or not the community is likely to be sound.

Chairman HEINZ. That makes me feel better, because I read that prospectus last night—I went to the Harvard Business School—and I could not understand it, either.

I think that is the key point.

I have taken enough time for questions. Before I yield to Senator Glenn for questions, let me just welcome Senator Wilson of California. Pete, if you have an opening statement, you can put it in the record, summarize it, even make it, if you would like.

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[1] Retained in committee files.

STATEMENT BY SENATOR PETE WILSON

Senator WILSON. Thank you, Mr. Chairman.

I will just say that I am very pleased to see this distinguished panel. Judge Jenkins is an old friend and someone well known to me, and someone for whom I have a profound respect. I read his testimony with great interest, and he states his position with characteristic eloquence and clarity. He used to serve with me on the board of directors of the League of California Cities, and one was never in doubt as to his opinion. I am particularly interested in the remarks that he had to make this morning. The subject of life care and continuing care is one of enormous interest to me. It is a subject in which I have had an interest since my early days in the California Legislature. In California, of course, we have more of these institutions than anywhere else in the Nation. I think that they serve a very useful purpose, but as with any grouping that includes so many, there are some that are very good, and some that leave a great deal to be desired, but I think, in our concern for those on the latter end of that spectrum, that we need to exercise the kind of care that Judge Jenkins has urged upon us in his testimony this morning.

I think there are things that can be done, and I think that in my State, the State law has addressed them—perhaps, as Judge Jenkins has indicated, addressed them with the best intentions, but perhaps, a little too comprehensively. Mr. Chairman, I am delighted that you have convened the hearing, because it is a clear fact that we are blessed with an increasingly aging population, and that is becoming of increasingly personal interest to me.

But I think that it is also clear that a fundamental distinction exists, as the testimony of Judge Jenkins points out, and that of the other distinguished members of the panel. It is difficult to generalize about the aging, just as it is impossible to generalize about people generally, except to the extent that you can generalize about the difference in their economic circumstances. Later, I would hope that I would be able to persuade you and the other members of the committee that we should examine a specific technique that might assist the nonprofits in this field, to deal with the harsh realities of the current day, and that is, increasing land prices and increasing prices in the cost of construction. That bears upon their overall economic viability.

In any case, I thank the members of the panel who have traveled so far and who have collectively amassed literally years of experience and knowledge to share with us.

Chairman HEINZ. Senator Wilson, thank you very much. I would only add that this is the first hearing, to my knowledge, that anybody has had in this, or in the last couple of Congresses, on life care. It is an oversight hearing to get a sense of how the industry is progressing and what its promise is. I think its promise, personally, is enormous, and we would like to see it prosper and grow and help us as a country solve many of the challenges and opportunities, and realize some of the opportunities, that can be realized as you and I grow older.

I want to ask Senator Glenn to proceed now with any comments or questions he may have.

Senator GLENN. Thank you, Mr. Chairman.

I do have a couple of questions. I am certainly the last one who is going to advocate a more intrusive role for the Federal Government where we can avoid it. But I wonder whether we are right in keeping this at the State level or local level completely, when we have cases like the ones reported in the FTC news on Christian Services International, Inc. They developed, marketed, or managed approximately 200 life care homes in 25 States, and they were enjoined to stop misrepresenting some of their views. So, it is obviously a matter of interstate commerce and interstate concern. It is a matter of using the mails, and it is a matter sometimes involving stocks and bonds. There are several different Federal agencies, it seems to me, that could maybe, without additional legislation, provide a very valuable function here in controlling what is beginning to be an industry that obviously needs some control. We must prevent the elderly from being devastated at a time when they have either turned over all their worldly goods or portions of them, and then stand a chance of being wiped out if that home is not properly managed. I would solicit your comments on whether you think the FTC should monitor these things. The FTC news release startled me, because we estimate there are 300 to 500 of these homes now, and here is one company involved with 200 of them—either managing, developing, or marketing. That is 40 percent, at least, that are controlled by one company, if these figures are correct. So, maybe there is an FTC role or an SEC role here that could well be explored.

What are your comments—and I would solicit anybody who wants to start out.

Judge JENKINS. Senator, if I might start by saying that I think there is probably some misconception with respect to that particular person or entity and what kind of involvement he had. We have a rather careful definition of continuing care or life care that involves the 200 to 400 that we are talking about here. I think that there are many other kinds of facilities that are involved that do not come within the 200 to 400, so we are talking nothing close to the 50, or 15, or 10 percent. I think it is a relatively small number—I gather that is Mr. Berg that you are talking about.

Senator GLENN. Well, let me just interrupt, if I could. Do you have any estimate or guess even as to what percent of these life care communities or life care homes would be run by companies or entities that deal in more than one State. That would put it in the interstate commerce category and then we would let SEC, FTC, or other people look at it. Do you have any idea on that?

Judge JENKINS. Probably a half dozen at the most, to my knowledge.

Mr. COHEN. Of course, almost every continuing care retirement community operates to some degree in interstate commerce, at least to the extent that it makes mailings across State lines to solicit residents from outside the State, to the extent that it sells bonds for financing, and even to the extent that it obtains a mortgage that is sold to the Federal Government. Although I agree that the big interstate nursing home chain does not yet play a big role in this industry, but I do think that the Federal Government possesses the power to regulate the industry.

Senator GLENN. If that is true, then what would be your opinions of FTC and SEC involvement. Go ahead, and I am sorry I interrupted your train of thought there, Judge Jenkins.

Judge JENKINS. With respect to SEC, obviously, that is an extraordinarily complicated set of regulations which, as you are aware, very much aware, and the Senate is aware, has not really resulted in solving all the problems relating to stock investment, prospectuses of the kind that Senator Heinz talked about. It unfortunately, I think, would result in a great level of additional regulation which would not go to the issues that really cause the problems for our facilities. We are talking about situations by and large where there is a lack of information by knowledgeable people on both sides, where we have management that has not been very good management in many ways. Regrettably, ministers do not make good businessmen on all occasions, and much of what has occurred through the years here has come from that background of well-intentioned people wanting to do good, but not having the business acumen to do what they should have done.

Senator GLENN. Under current SEC regulations, nonprofit organizations and churches are exempt from securities registration. They do not have to make disclosures and consumer safeguards or make normal financial responsibility reports. Perhaps that should be required. To the consumers in this particular spot, you cannot just say, "Buyer beware." Sometimes, people who are elderly may not be quite as sharp at figuring out what is best for them at that point as they might have been at a younger age, and so they are—I will not say duped every time—but they are coerced into something that might not have been in their best interest had there been a more complete disclosure. And that is the SEC approach that I think is worth looking at.

Judge JENKINS. We spent time in California under Senator Wilson back in the midsixties, with respect to the question of whether or not regulation in that State should be under the corporation's commissioner. I think all of us concluded after some extensive hearings that the Senator had, and so on, that that was not an appropriate way to proceed, that it did not ultimately protect the people we wanted to protect; it did not do the kinds of things we wanted to do; that it had too narrow a focus because we are talking about, as you indicated, the whole person and their total life.

Senator GLENN. How about FTC; what would you think of that?

Judge JENKINS. Again, they have in this instance worked, as you indicated, with the recent consent decree with respect to someone who had moved out of the nonprofit, essentially, into the proprietary, which put them within the jurisdiction of the FTC. I think the difficulty you have here is the one we talked about earlier. Do you single out this one part of the entire voluntary nonprofit sector of the United States to suggest that it goes under the FTC; is there a valid reason for doing that, when you have literally hundreds of thousands of other kinds of nonprofit entities, many of which also involve persons' lives and their finances, perhaps not to the degree this one does. Do you single this one out and again put it within that kind of a regulatory process? I would suggest to you again that, as Mr. Ball has indicated, we have a long way to go before we think that that one should be singled out in that way.

Senator GLENN. And I think I would be inclined to agree with you now. I am just trying to get at what would be some way of controlling what we see as abuses. It is tragic when people get wiped out. I would probably agree with you also that maybe ministers, while they are well-intentioned, are not always the best-trained businessmen. But for the people involved, it is an equal tragedy, whether it was poor administration by a minister, or whether it came from duplicity, or somebody deliberately misrepresenting the product they were trying to sell. The tragedy is the same for the individual involved. It seems to me that perhaps the FTC is not a bad spot to look into some of these things since, as you would say, most of them would have some sort of interstate connection, even if it is using the mails interstate for their advertising in some way.

If we just leave it to the States, it seems to me that some States will pick it up and do something about it, and some States will not, and we will continue having human tragedies at an age when people cannot afford any more tragedies than they already have.

Judge JENKINS. I would point out, Senator, that at least to my knowledge, California, although there have been problems particularly with respect to Pacific Homes, to my knowledge, no person has lost his assets, no one has been required to move out, not one person out of the many thousands that we have there has, in fact, suffered that result.

Senator GLENN. Well, how did you do it, then? How can we transfer that to 49 other States?

Judge JENKINS. Well, we have indicated, or Mr. Ball has, with respect to the question of the study that his committee has engaged in for the past year, that regulation is important, that there are a variety of regulatory processes that we would suggest be encouraged throughout the country. We should note that up until now, it has not been a large industry. You will have States, I know, such as Alabama, where there have been problems, but I think there have probably only been three or four homes that have been involved so far. We would certainly encourage their legislatures to look at some of the suggestions that have been made in the Ball study, and some of the things that have happened in other States, and to start the process of regulation at the local level.

Chairman HEINZ. Senator Glenn, let me just interrupt to say that I know Bob Ball and David Cohen have to leave at 11 a.m., and it is 1 minute to. So if you have any questions for either Bob Ball or David Cohen, I suggest that you ask them now.

Senator GLENN. Yes, on the same subject, for you two gentlemen, if you have any comments before you leave. Let me just add one statement before you make your statement. One of the problems we had in Ohio, in the Ohio Nursing Home Commission report in 1979, for instance, to the Ohio Legislature, was that they said it was impossible to determine exactly how many life care communities were operating within our own State, because there was nothing in our State licensure or Federal certification law for nursing homes which would indicate whether a facility was life care or not. That was another problem.

But let us get back to the FTC and how you think these could be controlled.

Mr. COHEN. All right. Let me say that I think your comment that the FTC and SEC have a role to play in this industry without any further legislation is absolutely accurate. For example, I am sure that there are SEC people right now looking into the Fiddlers' Woods situation.

Now, you might say that that is "too little too late," but the SEC did approve the prospectus before the bonds went on the market. Now, no resident is going to lose any money at Fiddlers' Woods because no resident moved into Fiddlers' Woods, and all the deposits were in escrow. But it didn't do the bondholders any good to have the SEC involved in that case.

The only thing the SEC could do, in my view, would be to improve disclosure. But I think that the type of disclosure with which the SEC is familiar, and with which it is used to dealing, is not going to be the kind of disclosure that is going to help residents or their advisers to cope with the problems of the continuing care industry.

You have, I am sure, some of the various disclosure proposals that have been proposed. Many of them are discussed in some of the materials [1] that I included with my prepared statement. It is those kinds of disclosure that meet the needs that you are talking about, and it is those kinds of disclosure—disclosure that residents and their legal advisers can understand, and that are designed specifically for the particular problems of the continuing care industry—that would be necessary. So I really do not advocate a greater role for the SEC beyond their traditional functions.

I should also add that my views on the FTC are quite similar. To the extent continuing care retirement communities advertise in interstate commerce, I think the FTC has a role to play under its current charge by the Congress. But I don't see any real benefit to expanding the FTC's role to deal specifically with other problems of the continuing care industry.

Senator GLENN. Just one other question. Has anyone ever explored any kind of insurance in this regard where, if someone put their savings into this, part of that goes to pay for insurance? Then, if there is a bankruptcy later, you would get back 80 or 50 percent—is that a possibility, or is that beyond the insurance capability?

Mr. COHEN. The recently enacted Indiana statute includes a concept like this. The statute established a "retirement home guaranty fund" that is essentially financed by all the continuing care retirement communities in the State. Under that statute, if a continuing care retirement community goes bankrupt and the operation of the community is terminated, each resident of the community is guaranteed some payment from that fund based on how much money is in the fund, the size of the resident's entrance fee, and the value of services provided to the resident over the years.

Senator GLENN. Yes, I know, but we had the Chrysler bailout at the Federal level, too, and that one happened to work. Maybe some other one would not work. But what I am interested in is protecting the individual who has sunk everything he owns, his whole life from there on. Is there some way we could at least get part of that

[1] Retained in committee files.

back if there was an insurance against bankruptcy, that every one of these places was required to pay into on a certain percentage? And I just run that by as an idea. I do not know whether it would work or not.

Mr. COHEN. I suspect that insurance of that kind would be very expensive, but I will let Howard talk about it. Some of the existing State statutes require continuing care retirement communities to post a bond so that they would be able to reimburse their residents for all their payments if the community goes bankrupt. To our knowledge in the study, however, no community was ever able to obtain such a bond. So I suspect that there is probably a practical marketing problem there.

Chairman HEINZ. I think it is time to excuse Bob Ball and Dave Cohen. Thank you very much.

Mr. COHEN. Thank you very much, Mr. Chairman.

Mr. BALL. Thank you, Mr. Chairman.

Senator GLENN. Dr. Winklevoss, I think you started to say something a moment ago. Did you want to comment on that—and I know my time is up, Mr. Chairman.

Dr. WINKLEVOSS. Your insurance idea is a very interesting one. If all residents demanded such insurance, and we could find underwriters for such insurance, the financial difficulties of these communities would disappear, because the underwriters would require, before they would issue insurance to that community, the kinds of financial assurance that would be required to maintain it.

Senator GLENN. That is right. That was going to be my next point.

Dr. WINKLEVOSS. I do not know how you get that started. Do you educate consumers to have a mass demand from the communities to get this, or do the underwriters take the initiative? It is a little bit like title insurance. My guess is—and I am not an expert in that field—my guess is that when we trade our houses, we pay a certain amount of money to the title insurance company to do something, and I have always considered that they do not do much, because I do not think there are very many claims. But the very important role that they serve is that there are few title disputes because of that whole mechanism being in place.

Senator GLENN. But if your title is bad later on and goes kaput later on, you can come back and sue, and that is what the title company is there for, and that is their insurance. That would be exactly the same function here. If the company is not solvent, is poorly managed, goes down, the people who put their trust in that company, then, would be made whole or partially whole again, and would not be left just destitute. It would seem to me that—let us say we have 500 companies involved in this whole thing, and let us say there are three or four bad apples in the pile that go bankrupt and leave people really destitute. It seems to me that for the good of the industry as a whole, you could well share that risk. Maybe you would make some fee, I do not know exactly how it would work, but it would seem to me that some type of insurance would be very valuable if we could work it out.

Dr. WINKLEVOSS. Well, if the underwriters were not forced to accept each community, then you would have the mechanism to put some pressure on them. Another approach—although I do not

think it is a good one, frankly—is in the pension field, where the Pension Benefit Guaranty Corporation was established to maintain the financial solvency of pension benefit plans with a premium from each employer. The problem there is that it is a passive organization that cannot go in and insist on the financial integrity of the pension plans, and I think you need that element to make your scheme successful.

Senator GLENN. Yes. Thank you.

Chairman HEINZ. Senator Glenn, thank you very much.

Senator Wilson.

Senator WILSON. Thank you, Mr. Chairman. I would be interested in Judge Jenkins' response beyond that which he has already made, specifically in response to the point about insurance.

Judge JENKINS. I think that Dr. Winklevoss essentially has covered that, and the problem that we see with respect to it. It has been considered, but it is clear that it has seen a relatively small industry. Underwriters simply are not interested. They are not interested in the "bad apples" that Senator Glenn talks about any more than they are in the regular insurance industry, the problems of rating, the problems of oversight are immense, and we do not have enough information to suggest that anyone in the insurance industry or underwriters would be willing to undertake that, even if there were premiums. And with most of what we have looked at, the same is true with respect to bonding. The reason for not having bonds is that costs have been prohibitive. And if we recognize that up to now, at least, we are really talking about nonprofit enterprises run by boards of directors of thousands of citizens like those who are in this room, who are not being paid for their services, and the only people who are putting money out are the people who are being served, and it is not then going to line the pockets of those who are on the boards of directors—now, that is exclusive of the problems that Mr. Lewis talked about, relating to contractors and others who are trying to get into the field at this stage—we find that the costs have become prohibitive already for people who want this way of life. To add a large insurance or bonding premium would—at least, I think—move us to another group of people again, a higher economically—people in the higher economic group. And we keep, then, eliminating more and more people who can be served. That is one of the problems.

Senator WILSON. Let me just ask Judge Jenkins what he thinks is an appropriate Federal role. He thinks that while there is no question that, from a jurisdictional point of view, interstate commerce affords the Federal Government jurisdiction, from a pragmatic standpoint, if we are trying to achieve needed regulation, it is local administration under State law to which we should look. I am inclined to agree with that. But, what about the problem that has been raised by Senator Glenn. There are some States that have not done this. What do you think the appropriate mechanism, if we had a model act, a State act—what inducement or what pressure do you see appropriate for the Federal Government to achieve enactment of that at the State level?

Judge JENKINS. I suppose at this stage, Senator Wilson, I have to say that I think that the history of the industry, as compared to the history of Federal regulation generally, is such, that at the

moment, it is too early to suggest that there is a particular role that the Federal Government should play.

I want to—and I agree with Senator Glenn—that if one person loses their life savings, it is of absolute significance and importance. It is also true with respect to many another kind of investment that people make—in tax shelters; people who lose their life savings in a variety of ways—that I decry.

Senator WILSON. But at an age where they can probably do something about it.

Judge JENKINS. Unfortunately, too many older people also get taken, Senator—many—and I find it is a part of some of the criminal process that I see in my court.

I have not found that Federal regulation has changed that, with respect to SEC or stock prospectuses, tax shelters, or gas and oil investments, and so on. Too many older people have been taken that way, too. I think that you need the local administration at this stage, and Senator, how we can enforce that is by this kind of a hearing and by this kind of an educational process; making people aware, making, we will say, the attorney general of Alabama, aware of what can be done in Alabama, or Ohio—and Ohio has had a problem, its legislature, as of course you are aware, Senator, back in the seventies. It started its inquiry with the 1977 report. Certain legislation was passed by you, a so-called 95-percent legislation was passed by that legislature in 1977. I think that by and large, that has resulted in alleviating, or eliminating, the kind of problem that earlier existed in Ohio, and it is public consciousness and legislative consciousness at the local level, where there is the ability to oversee it, that I think is significant.

Senator WILSON. Mr. Chairman, if I have a little time left, I would ask a quick question.

Chairman HEINZ. Yes.

Senator WILSON. As a judge, I assume you do not see any purpose or any need for the creation of any new Federal crime. You make the comment in your testimony that in virtually every State, there are on the books already statutes that cover cases of fraud and criminality.

Judge JENKINS. The answer is clearly, I do not. Not only do I not see, but I would question the validity of a new criminal statute at the Federal level, the enforcement of it, and what it would ultimately accomplish.

Senator WILSON. What defects would you point to in the California legislation, or regulatory apparatus?

Judge JENKINS. Senator, as far as defects, I suppose I could start, and we could spend the rest of the morning on why I think things have not been accomplished in the way they should have been, but by and large, the regulation which you were instrumental in passing, and instrumental in setting up in California, has been effective, and it is working. I have been chairman of the board of facilities with approximately 1,000 members. We sometimes are unhappy with the kind of inspection and requirements that we have on a yearly basis, but as Mr. Cohen has indicated, if you have disclosure, if you have registration, if you have certification, and if you have escrow provisions of the kind that we have in California,

you will, by and large, cover most of the problems involved, and I think that California is doing so.

Senator WILSON. Thank you.

Chairman HEINZ. Senator Glenn.

Senator GLENN. Thank you, Mr. Chairman.

I would just be interested in the insurance approach or FTC-SEC. Ms. Schwartz, you have not made any comment on this, or Mr. Lewis. Do you have any comments on that before we move on?

Ms. SCHWARTZ. No, I do not.

Mr. LEWIS. The failures over the past 15 years are chiefly due to cupidity—and a few because of incompetence. It would be grossly unfair to expect the honest providers and residents of their facilities to make up or cover for deception and fraud.

Senator GLENN. I feel the same way about automobile insurance.

Mr. LEWIS. That the art of administering continuing care communities is still rudimentary. Sufficient hard, basic actuarial and financial data is not available to set strict standards of operation. That, and the fact that these are social institutions with all the variables that implies, make it difficult to see how they could be regulated and controlled like insurance companies. But I agree with Judge Jenkins, we are just not there yet, knowing enough to really come up with the right numbers on this.

Senator GLENN. Thank you.

Chairman HEINZ. Thank you, Senator Glenn and Senator Wilson.

I have just one last question for Dr. Winklevoss, which is this. How fast and how easily can a facility that is on a good financial footing get into serious financial trouble?

Dr. WINKLEVOSS. Well, it can get into trouble quite easily, and how fast is a more difficult question, because it is a question of maturation or what stage of development they are in. But the crux of the financial problem is that the generally accepted accounting principles that accountants use in their financial statements of continuing care retirement communities are not adequate to properly disclose their long-term financial commitments. What happens is that the members and the boards of directors are embarrassed to have what you might call a bottom line profit in these communities, yet it is very clear that as a community starts up, you have to have a profit, that is, ability to have your financial health care reserves for about a 10- to 12-year period in order to remain in a financially viable condition. So it is a question of lack of understanding on their part, and there is a fair degree of underpricing.

I would say that the time in which these communities could get in trouble is a period of not 12 months, but several years, and it is a little bit analogous to one of these large ocean transporting vessels where, if you want to make a turn, it takes 10 or 15 miles to do that turn. Once you see some difficulty in these communities, chances are you have the tip of an iceberg, and the restoration of that financially, is extremely difficult once the problem manifests itself in the form of generally used accounting statements.

Chairman HEINZ. Very well. Dr. Winklevoss, Judge Jenkins, Ms. Schwartz, and Mr. Lewis, we thank you all for being here. I may have some other questions for each of you for the record. We have another panel that we need to attend to as well, but we thank you. Many of you have traveled very considerable distances—Judge Jen-

kins, in particular. I do not know why he would ever want to leave San Mateo to come to Washington, D.C. And to my constituents from Pennsylvania, we are glad that you did not have to come so far, but we are indeed glad that you did come.

Thank you very much.

Our next panel consists of several individuals whose experiences demonstrate the problems and risks that are associated with life care. We will hear from an elderly woman who lost most of her life savings when a life care community went bankrupt and its operator convicted of fraud. We will hear from a State prosecutor who has brought a 150-count fraud indictment against one of the Nation's foremost life care operators. We will hear from a Commissioner at the Federal Trade Commission, who will tell us the outcome of that agency's 2-year-long, nonpublic investigation of certain aspects of the life care industry.

Will Helen Bishop and her son, Sgt. Jack Bishop; Assistant Attorney General Patrick Robinson; and FTC Commissioner Patricia Bailey and staff attorney Henry Whitlock, please come forward?

As with the past panel, witnesses will be asked to limit themselves to a 5-minute oral statement, and we will save all questions until those statements have been completed.

Our first witness in this panel is, if I am allowed to say so, 71-year-old Helen Bishop. Mrs. Bishop was a resident of a life care community that went into bankruptcy. She lost a substantial portion of her life savings through her involvement with that community, and she will tell us today of her experience.

Mrs. Bishop is accompanied today by her son, Jack Bishop, of the Mobile, Ala., Police Department. Sergeant Bishop is a graduate of the FBI Academy, and he has been working on business frauds for 5 years. When the committee was conducting its recent national survey of frauds against the elderly, it was Sergeant Bishop who wrote us to tell us of, in his own words, a very personal experience that he had encountered with respect to life care facilities, namely, that one involving his mother, Helen Bishop [see appendix, item 3].

So, we want to welcome both Sgt. Jack Bishop and Helen Bishop here to the committee.

Mrs. Bishop, would you please proceed?

STATEMENT OF HELEN BISHOP, MOBILE, ALA.; ACCOMPANIED BY HER SON, SGT. JACK BISHOP, MOBILE, ALA., POLICE DEPARTMENT

Mrs. BISHOP. My name is Helen Bishop. I am 72 years old, and I live in Mobile, Ala. My husband and I moved to Mobile in 1942, purchased a house, and lived there for 19½ years. In the middle of 1977, I began seeing advertisements on television and in the paper for a retirement community called Alabama Meadows. I had lost my husband, and was concerned about living alone, and possibly being a burden to my children.

I was especially interested in Alabama Meadows as they promised to build a nursing facility and have a full-time nursing staff. I felt that I could be independent living there, but my health would still be protected. I visited the facility about seven times. I called the Better Business Bureau, as well as had my lawyer check the

contract. When I felt that everything was OK, I then allowed the sales staff at Alabama Meadows to sell my house, which was worth $18,000, in exchange for an endowment to enter in the retirement facility.

I was given a temporary one-bedroom apartment in exchange for my house, and promised a permanent apartment of my choice in the future. I lived in this temporary apartment for 3 years. In the contract, I was promised that the maintenance fee would never be increased more than the increase in social security, which at that time was 5 percent. When I moved in, the maintenance fee was $147.

In December 1978, the first owner of Alabama Meadows, Rev. James Ballard, was convicted of fraud and sentenced to 9 years in prison. He was removed from the premises by the Alabama Securities Commission. Dr. Kenneth Paul Berg, who took over the facility, was himself later indicted for fraud. Here is what happened. In November 1979, Dr. Berg raised the maintenance fee to $166; in April 1981, it was raised to $234; and finally, in October 1981, it was raised to $399. At this time, I refused to pay the increase because I never received any of the benefits I was promised, including the nursing facility, and the few benefits we did get were being cut back. Also, I knew many of the residents had loaned money to Dr. Berg and had received from him personal promissory notes. They were being allowed to not pay maintenance fees in exchange for Dr. Berg paying back the money he owed them.

I decided to leave Alabama Meadows. My son helped me purchase a mobile home, where I can live at less expense than I would have had to pay at the retirement community.

I was so upset with my experiences with Reverend Ballard and Dr. Berg that I wrote a letter to the attorney general of Alabama and lodged a complaint with them. I am told that my complaint, the first they received about Alabama Meadows, helped start the State's investigation of Dr. Berg. I understand that the attorney general has indicted Dr. Berg on 150 counts of securities fraud. While I am not happy about my experience with life care, I am glad to see that I had a hand in seeing that justice may be done.

My son is Sgt. Jack Bishop of the Mobile, Ala., Police Department. He may wish to make a brief comment about my experience and how it compares to his work as a police officer, dealing with fraud every day.

Chairman HEINZ. Sergeant Bishop, do you have anything you would like to add to that, any statement you would like to make?

Sergeant BISHOP. Yes, Senator.

I have been a police officer for 23 years. Of those 23 years, 6 years have been investigating fraud-type thefts. I might be a little biased because of my mother being involved in this, but I do not believe I have ever seen a more callous act than these acts perpetrated by these two men who have already been mentioned.

My mother's will for independence overcame good sense on my part, and that fierce will for independence has cost us both a great deal.

Chairman HEINZ. Sergeant Bishop, thank you very much.

Our next panelist is Patrick Robinson. Mr. Robinson is assistant attorney general for the State of Alabama. He is going to testify on

the investigation and prosecution of the Reverend Ballard and Rev. Kenneth Berg. These individuals have been mentioned, and operated a life care retirement village in Mobile, Ala., which has been forced, as we have seen, into receivership.

Mr. Robinson.

STATEMENT OF PATRICK L. ROBINSON, MONTGOMERY, ALA., ASSISTANT ATTORNEY GENERAL, STATE OF ALABAMA

Mr. ROBINSON. Thank you, Senator.

I have a brief statement which I would like to submit for the record.

Chairman HEINZ. Without objection, so ordered.[1]

Mr. ROBINSON. Attorney General Charles Graddick requested that I convey his regrets to you that he personally could not testify before the committee today.

The Alabama attorney general's office prosecuted Rev. James Ballard in October 1981, for securities fraud. Ballard is now serving a 9-year sentence in connection with the sale of $2.1 million in worthless bonds for the Meadows, a life care retirement facility located in Mobile, Ala. Ballard operated The Meadows through a nonprofit corporation called Christian Fellowship Foundation, Inc. The Meadows is located on Fellowship Drive. In selling the bonds, Ballard failed to disclose that the bonds would be encumbered by a $300,000 prior debt incurred by Christian Fellowship Foundation at a defunct project in Ocala, Fla. Ballard also used the proceeds of the Mobile bond sale, and the proceeds of life care endowment sales, to purchase several personal items. He purchased a yacht, an airplane; he leased several vehicles, including a Cadillac deVille d'Elegance. He made a $10,000 downpayment on a personal residence. Although he preached abstinence of alcoholic beverages, he used the elderly residents' money to buy alcohol and pay country club dues. He traveled constantly across the United States, staying in the best hotels, dining at the best restaurants. His purpose was to study life care. He bought thousands of dollars' worth of clothes for himself and his wife, including ladies' lingerie and a cowboy outfit, complete with riding chaps and lariat. He had his entire family on the Christian Fellowship payroll.

Ballard's activities relating to the sale of life care were equally outrageous. He advertised in religious periodicals which often pictured him surrounded by religious leaders. Ballard's marketing plan implied that Christian Fellowship Foundation was a religious ministry, which it definitely was not.

When prospective purchasers visited The Meadows to inquire about life care, Reverend Ballard or his son would often meet them back at their house and be waiting for them on their doorstep. They promised them a swimming pool, tennis courts, limousine service, a library, a village church, a recreation and health club building, an amphitheater, a nursing home, and hundreds of additional life care apartments. All these things were promised at a time when Reverend Ballard knew he could not fulfill any of the promises.

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[1] See page 50.

Ballard and his agents would often sell houses belonging to the elderly in order to enable the elderly to raise money to get into The Meadows. In one instance, a lady's house sold for $19,000 more than the endowment, and when the lady asked Ballard for her money, he told her it was tied up, and he gave her a promissory note, which later turned out to be worthless.

In another instance, a lady had a house full of antiques which would not all fit into her apartment she was going to move into, so Reverend Ballard offered to buy the furniture that would not fit into the apartment. He got the furniture, and when the lady wanted her money for the furniture, Reverend Ballard told her it was tied up, and he gave her stock in a company which just previously, the Alabama Securities Commission had told him to cease and desist from issuing that stock.

On March 7, 1983, Dr. Kenneth Paul Berg, a nationally known retirement village entrepreneur, who had been under intensive investigation by numerous States and Federal agencies, was indicted on 150 counts of securities fraud and theft by a Mobile County grand jury. The charges stemmed from Berg's operation of the same retirement village that Ballard was involved in.

Berg owned and operated a management consulting firm called Christian Services International, Inc. Berg's trial will probably be held this summer, and I cannot really go into any detail on what he did, except that the indictment alleges that he issued $213,000 worth of promissory notes and annuities, primarily at 17 percent interest, to the same residents who were victims of Ballard. The average age of a resident at this village is 80 years old.

The indictment alleges—and I will keep it very brief, because I know my time is probably up—that Berg failed to make certain disclosures which he should have made. For instance, he was being sued for racketeering in Missouri; he was under investigation by the FTC; he was being sued for $7 million; he was in default on $2.2 million in promissory notes; the indictment alleged that he had a ditch dug to give everybody the impression he was building a building when, in fact, it was just a ditch used to encourage the sale of the life care endowments and the purchase of these promissory notes; and finally, he failed to tell them that after Reverend Ballard's association with The Meadows was terminated by the Mobile County Circuit Court, prior to being put in jail, Berg hired Ballard to work for him in Kansas City.

In conclusion, I would like to thank you for having me here. I would like to make one comment on something that a prior panelist said about ministers not making good businessmen. I think it is pretty obvious that in the ministry, just as in a lot of other professions, there are some real crooks, and I think especially in the case of Reverend Ballard, which is something that has been adjudicated, that has been borne out. And honest people in the life care industry should welcome some sort of uniform, stringent, nationwide life care standards, because the elimination of these fly-by-night con artists like Reverend Ballard can only help the industry.

Thank you.

Chairman HEINZ. Mr. Robinson, thank you very much.

[The prepared statement of Mr. Robinson follows:]

PREPARED STATEMENT OF PATRICK L. ROBINSON

Members of the committee, ladies and gentlemen, my name is Patrick L. Robinson and I am an assistant attorney general for the State of Alabama. Attorney General Charles A. Graddick requested that I convey his regrets to you that he personally could not testify before this committee today. Mr. Graddick feels very strongly that the problem which this committee is addressing is a matter of paramount importance. The continued ripoff of the elderly in the State of Alabama is a matter with which Attorney General Graddick is very concerned and he fully supports this committee in its efforts to investigate the concept of "life care."

The Alabama attorney general's office prosecuted Rev. James Ballard in October 1981, for securities fraud which he committed in 1977 and 1978. Ballard is now serving a 9-year sentence in Alabama's Fountain Correctional Institution in connection with the sale of $2.1 million in worthless bonds for The Meadows, a "life care" retirement facility located in Mobile, Ala. Ballard operated The Meadows through a nonprofit corporation called Christian Fellowship Foundation, Inc. The Meadows was located on Fellowship Drive. In selling the bonds, Ballard failed to disclose that the bonds would be encumbered by a $300,000 prior debt incurred by Christian Fellowship Foundation, Inc., at a defunct project in Ocala, Fla. Ballard also used the proceeds of the Mobile bond sale and the proceeds of "life care" endowment sales to purchase personal items such as a yacht and an airplane. Ballard leased several vehicles, including a Cadillac deVille d'Elegance and made a $10,000 downpayment on a personal residence. Although he preached abstinence from alcoholic beverages, he used the elderly residents' money for country club dues and alcohol. He also traveled constantly across the United States in order to "learn more about life care," staying at resort hotels, and dining at posh restaurants. He bought thousands of dollars of clothing for himself and wife, including ladies lingerie and a cowboy outfit complete with riding chaps and lariat. He had his entire family on the Christian Fellowship Foundation, Inc., payroll at high salaries. For example, Ballard's daughter was the "transportation director" at The Meadows. Her job consisted primarily of driving a handful of residents to a local shopping center a couple of times a week. His son was employed as his personal pilot.

Ballard's activities relating to the sale of "life care" were equally outrageous. Ballard advertised in religious periodicals which often pictured him surrounded by religious leaders. Ballard's marketing plan implied that Christian Fellowship Foundation was a religious ministry. It definitely was not. When prospective purchasers of "life care" visited The Meadows, Ballard or his son would often be waiting for the prospective purchasers at their doorstep when they returned home. Ballard and his agents promised the prospective purchasers that The Meadows would soon have a swimming pool, tennis courts, limousine service, a library, a village church, a recreational and health club building, an amphitheater, a nursing home, and hundreds of additional "life care" apartments. All these things were promised when Ballard knew that he could not possibly fulfill the promises. Ballard and his agents would offer to sell houses belonging to the elderly in order to enable the elderly to raise money to purchase a "life care" endowment. In one instance, Ballard sold a house for $19,000, in excess of the value of the life care endowment. When the elderly resident asked for her $19,000 she was informed by Ballard that the money was "tied up" and she was given a worthless promissory note bearing 10 percent interest. Another resident who moved into The Meadows could not fit all of her furniture into her apartment. Ballard bought several items of antique furniture. A couple of months later, the lady asked Ballard to pay for her furniture and he refused. Instead, Ballard paid her in worthless stock, despite the fact that the Alabama Securities Commission had ordered Ballard to cease and desist from the sale of the securities.

On March 7, 1983, Dr. Kenneth Paul Berg, a nationally known retirement village entrepreneur, who has been under intensive investigation by numerous State and Federal agencies, was indicted on 150 counts of securities fraud and theft by a Mobile County grand jury. The charges stem from Berg's operation of The Meadows retirement village in Mobile. Two of Berg's former associates in operating The Meadows also were indicted for theft.

Berg, who currently resides in Stilwell, Kans., is a founder of the "life care" concept of retirement living. Berg owned and operated a management consulting firm called Christian Services International, Inc. (CSII). He often bought retirement villages through a nonprofit organization which in turn would hire one of his corporations to manage the project. The management corporation would then contract with other Berg corporations for services such as advertising, printing, and construction.

Berg arrived in Mobile in December 1978 to take over The Meadows, a financially failing retirement development which had been placed under conservatorship by Mobile County Circuit Court at the request of the Alabama Securities Commission. Berg's predecessor at The Meadows was Rev. James Ballard. Many of the elderly residents who were victims of Ballard's crime are also alleged to be victims of Berg.

Berg's trial will probably be held this summer in Mobile. For obvious reasons, I cannot go into any great detail about the State of Alabama's case against Berg. I can briefly summarize the allegations contained in the indictment and other public documents. During 1979 and 1980, Berg issued promissory notes and annuities in excess of $213,000, primarily at 17-percent interest, to elderly residents of The Meadows. Such promissory notes and annuities are securities regulated by the Alabama Securities Act. Berg failed to register these securities with the Alabama Securities Commission in violation of code of Alabama 1975, § 8-6-4.

The Meadows residents average age is 80. It is alleged that they loaned money to Berg because of the high rate of interest because they were led to believe the money would be used to keep The Meadows operating, and they would not have made the loans otherwise.

Several of the residents said they were told Berg had made a substantial personal investment in The Meadows, which it is alleged that he had grossly exaggerated.

Berg set up a display of artists' renditions of various out-of-State retirement villages in the lobby of The Meadows and included the drawings in sales promotion packets he gave to prospective Meadows residents. Residents said the display indicated to them that Berg or his corporation owned or operated those villages. Not only did Berg not own or operate many of the villages, some of them did not exist.

A resident of The Meadows filed a complaint with the attorney general's office in September 1981. She alleged that many of the benefits promised to her in her "life care" contract had not been fulfilled, that maintenance fees charged residents were escalating beyond reason, and that Berg had obtained loans from residents that he had not repaid.

A subsequent investigation resulted in Berg's indictment which alleged that Berg had misrepresented both his own financial condition and the use to which he would put money obtained from the residents, in violation of code of Alabama 1975, § 8-6-17(2) (securities fraud) and § 13A-8-3 (theft by deception).

Examples of Berg's alleged false and misleading statements are:

(1) He failed to tell residents of The Meadows that he and his various corporations were defendants in a Federal class action suit filed in Kansas City, Mo., by hundreds of retired residents of John Knox Village of Lee's Summit, Mo., under the Federal corrupt organization statute (RICO) alleging that Berg had engaged in a pattern of racketeering activity.

(2) He failed to tell residents of The Meadows that he and his various corporations were under investigation by the Federal Trade Commission.

(3) He failed to tell residents of The Meadows that he and his various corporations were defendants in civil suits throughout the United States in which damages totaling in excess of $6.7 million were being sought.

(4) He failed to tell residents of The Meadows that he and his various corporations were in default on promissory notes totaling in excess of $2.2 million.

(5) He failed to tell residents of The Meadows about the true status of his relationship with various other retirement facilities in the United States. The most flagrant examples are proposed retirement villages at Harvard and Orland Park, Ill., and Perry, Iowa, where the elderly paid hundreds of thousands of dollars for "life care" endowments but no retirement facilities were ever constructed.

(6) He failed to tell residents of The Meadows that a ditch dug on the premises of The Meadows for the alleged purpose of "footings" was in fact not dug for the purpose of constructing a building but was dug merely to promote the sale of notes to the elderly residents and to sell "life care" endowments to prospective residents.

(7) He failed to tell residents of The Meadows that after Reverend Ballard's association with The Meadows was terminated by the Mobile County Circuit Court (prior to his incarceration), Berg hired Ballard to work for him in Kansas City.

The indictment contained 143 counts for securities fraud and seven counts for theft by deception. Each security fraud count carries a maximum sentence of 10 years and a maximum fine of $15,000 upon conviction. Each theft by deception count carries a maximum sentence of 20 years and a maximum fine of $10,000 upon conviction.

The Iowa, Illinois, and Missouri attorneys general's offices currently are investigating Berg and these agencies were of great assistance to the Alabama attorney general's office in its investigation of Berg.

The Regional Organized Crime Information Center (ROCIC) located in Memphis, Tenn., was instrumental in helping to coordinate the investigation. In addition, the following agencies were of great assistance: Federal Trade Commisison, New York Division; Florida Department of Law Enforcement; Glendale, Calif., Police Department; Hillsborough County Sheriff's Department, Tampa, Fla.; Hunderdon County, N.J., District Attorney's Office; Johnson County, Kans., District Attorney's Office; Los Angeles County, Calif., District Attorney's Office; Kansas Securities Commission; Memphis, Tenn., Police Department; Missouri Securities Commission; Nebraska Department of Banking and Securities; States' attorneys offices in Daytona Beach and Fort Lauderdale, Fla.; Texas Attorney General's Office; Texas Department of Public Safety, Criminal Intelligence Division; Texas State Securities Board; U.S. Department of Housing and Urban Development, Kansas City Division; U.S. Postal Inspectors, Chicago and Kansas City Division.

The Alabama Attorney General's Office has not conducted a study of the "life care" industry per se. However, in the course of investigating and prosecuting Reverend Ballard and Reverend Dr. Berg we have gained a certain amount of knowledge on the subject. Attorney General Graddick has considered the FTC consent agreement with Dr. Berg dated March 1, 1983, and he agrees in most part with the FTC requirements. Mr. Graddick feels, however, that the placing of the proceeds of endowment sales in escrow should be absolutely mandatory. There are just some things that shouldn't be allowed even if they are fully disclosed. It is Attorney General Graddick's firm opinion that some super salesman should not be allowed to talk a senior citizen into gambling his entire life savings on the success of a "life care" project.

In conclusion, I would like to thank you for inviting me to testify about this matter. During the course of this investigation we have learned that there are many successful "life care" complexes in Alabama and throughout the United States and that the residents of these villages are very happy with "life care" retirement living. In addition, I have personally interviewed many of Dr. Berg's former employees who currently operate their own "life care" consulting firms. These individuals appear to be honest, sincere, and highly professional. The honest people in the "life care" industry should welcome uniform stringent nationwide "life care" standards because the elimination of fly-by-night con artists like Rev. James Ballard can only help the "life care" industry.

Thank you.

Chairman HEINZ. Our next two witnesses are Pat Bailey of the Federal Trade Commission—somebody who has appeared before our committee on numerous occasions. This morning, she is going to discuss the outcome of a 2-year nonpublic investigation of certain companies and their practices in the life care industry. Their work, I am told, has resulted in Dr. Kenneth Berg, one of the leaders in the life care industry, entering into a consent agreement to cease and desist from a variety of deceptive practices [see appendix, item 4]. Henry Whitlock, Federal Trade Commission staff attorney, who carried out much of the Commission's investigation of this industry, accompanies her.

STATEMENT OF PATRICIA P. BAILEY, WASHINGTON, D.C., COMMISSIONER, FEDERAL TRADE COMMISSION; ACCOMPANIED BY HENRY WHITLOCK, STAFF ATTORNEY, NEW YORK, N.Y., FTC REGIONAL OFFICE

Commissioner BAILEY. Thank you, Mr. Chairman.

Mr. Whitlock is the leading staff specialist in the Federal Trade Commission on this investigation, so he will be available to answer questions that you might have, that I might not know the answers to.

I appreciate the opportunity to participate in these hearings concerning the life care industry. As has been indicated by previous witnesses, life care is potentially a very significant concept for our society. It is an important nongovernmental response to the major

concerns of almost all Americans for their postretirement years. It will work, as has been pointed out frequently, in any individual facility only if, first, the home is soundly secured financially and operating under an adequate plan, forecasting future needs; second, where monthly fees and any necessary increases are within the capacity of the residents to bear, recognizing that most of them will be on fairly fixed incomes; and third, of course, is if there is an absence of any misrepresentation or deception in the marketing of the facility.

The Federal Trade Commission began its investigation of the life care industry in 1978. We have recently entered into a consent agreement with Christian Services International, Inc., and Dr. Kenneth Berg. As you know, Mr. Chairman and Senator Wilson, by entering into a consent agreement, Dr. Berg and CSI do not admit liability for violating the Federal Trade Commission Act, but they do agree to cease and desist certain practices. Under that agreement with CSI and Dr. Berg, they have agreed to cease and desist a number of practices primarily going to the misrepresentation of the financial risk of entering into a life care contract.

I think there has been some discussion here today about the size of this industry, and enough has been said, I believe, for you to know that real information, hard information, about it is scarce. Using all available sources that we have, we believe that there are at least 300 life care communities, housing upward of 100,000 residents, with an annual revenue exceeding $1 billion.

Now, growing out of our experience with CSI, what should potential residents be alert to, and what information should they demand before entering into a life care contract?

First, has the life care home furnished prospective residents with financial statements which will permit an accurate assessment of the facility's current financial stability? Has the home allowed a sufficient period of time, in advance of signing the contract, to review such materials?

Our consent agreement requires CSI to cease representing that there is little or no financial risk involved in entering into a life care contract, to cease misrepresenting the financial condition of its homes, and to provide financial statements prepared by independent auditors. It requires that all of that data must be available to prospective residents 5 days before they sign a contract.

Second, is there an explicit or implicit claim that the home is affiliated in any way with a religious or charitable organization? That suggestion is often implicit in the names of the organizations or homes, but often it is not the case. Christian Services International, for example, despite its name, is not affiliated with any church or denomination, but is instead purely a for-profit corporation. Many of the homes it promotes and manages are named "John Knox Village," and while John Knox was the founder of the Presbyterian Church, these homes are not in any way affiliated with the Presbyterian Church. Even where homes may be actually affiliated with a religious organization, the church's commitment to them may not be of a nature to avoid disaster if they are unsoundly structured and managed—and that is the experience which you have heard about concerning Pacific Homes in California,

which represents, by the way, the largest collapse in this industry to date.

Our consent agreement requires CSI not to misrepresent any religious affiliation and to disclose fully the precise nature of any such affiliations which might exist and the extent to which any organization, religious or otherwise, will be responsible for any financial or contractual obligations.

Third, what does the home do with the advance entrance fee? Is it escrowed, invested, or reserved in a manner which insures lifetime care? Or, is it reserved for mortgage payments, used for current or future construction, or used in any other manner which may render future—that is, lifetime—care speculative?

Our consent agreement requires that prospective residents be provided with information as to the uses of the entrance fees and any mortgage or other financial claims against the home that have a priority over the resident's financial interest.

Fourth, what are the service fee arrangements? How much might they increase as matched against a prospective resident's present and potential future income?

Our consent agreement requires disclosures concerning the use to which service fees are put and prevents CSI from representing that they will never increase, and requires disclosures as to when and on what basis they will be increased. The primary misrepresentation involved here, as in the case of Mrs. Bishop, was the claim by CSI that the service fee increases would never exceed corresponding social security increases.

There are other terms and conditions of this consent agreement. They are in my written testimony, which I would appreciate being submitted for the record, Mr. Chairman. But those are the major points that I wanted to go over.

Chairman HEINZ. Well, if you have 1 or 2 more minutes' worth of statements you want to put on the record, we can.

Commissioner BAILEY. Let me just add one thing. It has been said before that the population group we are talking about—and that is really the key here—is mostly middle-income citizens. For many if not most of these people, their home is their most valuable possession. It is important to understand that selling that home for the purpose of being able to enter into a life care contract can be a very good investment. But you do not acquire any equity when you enter into a life care contract. You do not have even a lease to the premises that you are living in. All you have is an occupancy license, which gives you the right to live on those premises only so long as you continue to pay the monthly fee. That is an enormous exchange, and it is for that reason that we must be very cautious. I hope this committee and my Commission can continue to the degree that we are able to keep an eye on developments.

Chairman HEINZ. Commissioner Bailey, thank you very much. The Federal Trade Commission consent decree will be entered into the record at this point [see appendix, item 4].

[The prepared statement of Commissioner Bailey follows:]

PREPARED STATEMENT OF PATRICIA P. BAILEY

I appreciate this opportunity to participate in the committee's hearing concerning life care homes for older Americans.

Life care is a fairly new and potentially quite significant concept which links retirement community living for the still independent, well elderly with the guarantee of future long-term nursing care, as required. It represents a unique nongovernmental attempt to address the major problems facing the elderly: The need for financial security, health care, and adequate living arrangements. With an ever increasing older population seeking postretirement housing and health care alternatives, this fast growing industry holds out the prospect for a secure old age for a growing number of mainly middle- and upper-middle-income citizens.

At the same time, the concept of life care is complicated and certainly not risk-free. If the life care home is to fulfill its promise and its goal, it must be soundly based financially and operating under an accurate forecast of future needs. Otherwise its stability will be speculative at best and its residents in personal and financial peril.

The Federal Trade Commission has examined the marketing and management practices of some members of this industry, and I welcome the opportunity to share with you some of the information and insights we have gleaned from that experience. It is vital that life care home developers understand what can occur in the absence of proper planning. And it is absolutely necessary for prospective residents to be alert to possible misrepresentations and to require full disclosure of the financial risks involved in entering into life care contracts.

Briefly, what is involved in the life care concept is this:

A resident enters into a life care contract with a home which involves the purchase of a lease for life in a living unit through the payment of a lump sum entrance (or endowment) fee, and the obligation to pay future monthly service fees. In return, the resident is entitled to the lifetime use of a living unit and guaranteed lifetime nursing care, as required, plus, depending on the home and the contract, a variety of other services and amenities.

Clearly, therefore, the life care industry can become increasingly significant for growing numbers of our citizens and for the society as a whole. But just as clearly, potential residents need to understand the nature of the financial risks involved, and each facility must be soundly based and operating under adequate financial planning. Otherwise the promise and the hope of life care can be illusory and the loss to residents financially catastrophic.

Fees for life care vary, but the entrance lump sums required currently range from $15,000 to $50,000, and some may even be substantially higher. Monthly fees or service charges range from $250 to $500. It is important to recognize that despite the lifetime nature of the contract, residents obtain no equity interest on the dwelling unit they occupy. They receive only an "occupancy license" which entitles them to live in the unit so long as they continue to pay the monthly service charge, unless they have been confined to the home's nursing care facility for an indefinite period.

Reliable data relating to the present dimensions of the life care industry are scarce. Most life care communities have been developed during the past 5 to 10 years, with a significant increase in the last 2 or 3 years. Our best estimate based on all available sources is that there are at least 300 life care homes in existence, housing upwards of 100,000 residents. The total annual life care industry revenue appears to be in the area of $1 billion.

The Commission began its investigation of the life care industry in 1978 after our staff received a number of complaints from residents of life care facilities. These initial complaints charged that the sales presentations and promotional materials used to induce the purchase of life care contracts had misrepresented the medical care and other services to be provided, as well as the costs of those services.

In response to the growing number of complaints, our staff targeted for inquiry several for-profit management companies, which, based on the complaints received, were thought to have engaged in such practices. Our staff quickly discovered, however, that, in the case of at least one major company involved in the industry, Christian Services International, Inc., the pattern of deception was actually far more complex and unsettling than the complaints had indicated. With many thousands of retirees already in residence, and an active promotion program ongoing, certain Christian Services, or "CSI," managed homes appeared to be underfunded from their inception and therefore likely to prove unable to deliver the lifetime care promised to residents. Because of CSI's prominence in the industry and because of the fundamental problems with some of the homes with which it was involved, our staff narrowed its investigation to an in-depth inquiry into CSI's activities.

CSI is a proprietary corporation which generally sells its all-encompassing contract services to nonprofit life care homes. Incorporated under another name in 1968, CSI has helped to plan, develop, structure financing for, promote, market,

design, supervise construction of, and operate more than 50 life care homes in 17 States, including the largest life care facility in the country. Industry data shows that, while most life care homes are nonprofit institutions at this time, at least 33 percent of them are managed by for-profit contract managers like CSI.

The result and the product of our investigation of CSI is a consent agreement offered by the company which the Commission has tentatively accepted. The agreement is currently on the public record for comment and will be considered for final acceptance after June 27 when the comment period closes. The agreement requires that CSI cease and desist from certain practices and provide certain significant types of disclosures to prospective residents. I will indicate the types of requirements and disclosures that the order contains in the context of a more generalized discussion of what the Commission has learned from this investigation that can serve as guidance in the future for both residents and developers of life care homes. In settling the case, CSI did not admit liability for a law violation. The facts I will discuss below, therefore, reflect only the findings of the Commission's preliminary investigation, as alleged in the complaint which accompanied the consent agreement.

FINANCIAL RISK

Unless a life care home is partially supported by contributions from a religious denomination or other charitable organization (which though often suggested appears to be uncommon), then it is entirely dependent for its financial well-being on revenues derived directly or indirectly from its resident (endowment fees, monthly service fees, and medicare payments for residents occupying nursing beds). The key selling point for the concept of life care is that this pooling of resources and incomes will provide each resident with individual security and enable the home to fulfill its promise to provide lifetime care. In theory this can work: Residents selecting similar units will pay the same endowment fee, but not all residents will require the same services, because some will live longer than others. If the "surplus" paid by some residents is reserved (and is adequate) to cover the excess of services required by others, then pooling will effectively preserve the financial integrity of the home which stands behind the promise to provide lifetime care.

The premise of the pooling arrangements will prove false, however, if the reserved "surplus" is inadequate to cover the future needs of the home's population, or if there is in fact a substantial deficit which cannot be made up through increases in the monthly fees. This is an important consideration because the population of the homes consists, as an inevitable consequence of the sales pitch which emphasizes financial security, of persons with relatively fixed incomes. Even prudent residents who select units with lower monthly fees in order to leave a safety margin for the effects of inflation over their expected lifetimes, cannot cope with fee increases which exceed the range for which they have planned. Therefore, information as to the financial structure of the home is crucial to the assessment of a claim that purchasing a life care contract will provide security for the resident and a valuable guaranty of lifetime care.

The life care industry has a history of bankruptcies and homes that have experienced serious operating difficulties because of inadequate financial planning. In part, this may have occurred because the homes have been planned and financed as if they were real estate ventures (such as retirement condominiums), with endowment fees being used to cover initial construction costs. Reserves are either not established or are inadequate to cover the increased cost of operations when the initially healthy population (good health is an entry condition) begins to require nursing care, at an increasing rate, after several years of operations. Some managers have dealt with these problems, at least at first, by using entrance endowments generated through population turnover to cover current operating expenses. However (and I don't want to appear insensitive here, but these are the facts), it appears that in some cases resident mortality rate is not high enough to provide adequate income through turnover and endowment fees have to be increased and sometimes physical expansion of the home is undertaken to generate additional short-term improvement of cash flow. This approach has been characterized as a present day "Ponzi" scheme [1] because it requires the production of ever-increasing amounts of cash from

[1] The problems with this kind of scheme to raise money were demonstrated on Feb. 18, 1977, when Pacific Homes, a chain of institutions sponsored by the Methodist Church, filed for reorganization under chapter X of the Bankruptcy Act. This proceeding affected nearly 2,000 elderly persons and is the largest collapse in the industry to date. An analysis of the report of the trust-

Continued

a limited population group to whom contracts can be sold, while simultaneously incurring unfunded future liabilities (to provide lifetime care), often at a geometric rate of progression.

Thus, the promise of lifetime care, which is the subject of both explicit and implicit claims, may fail if financial arrangements are inadequate. It is clear, however, that all residents believe such claims or they would not purchase life care contracts. It is also clear that the potential for injury goes beyond the mere failure to fulfill a promise which was illusory from the outset. Commonly, residents will sell a personal residence in which they have a substantial equity to occupy a dwelling unit in which they have no equity interest at all—not even a lease. They pay the equivalent of a monthly rental for the premises on the understanding that the endowment payment guarantees the home's ability to provide lifetime nursing care, should it be needed. If the endowments are not reserved in sufficient amount to provide for this purpose, then the resident may in fact receive nothing at all in exchange for a substantial payment. The right to occupy a residential unit does not constitute value received from the endowment fee because the resident must also pay a monthly service fee which is roughly equivalent in amount to the rental cost of a comparable apartment.

Accordingly, the Commission believes that meaningful financial disclosures must be made to prospective residents so that the promise to provide lifetime care (and the claim that this is a secure arrangement) may realistically be assessed. During the course of the investigation, it became apparent that many residents of homes have the background and experience necessary to read financial disclosure statements and make reasonable judgments as to their contents, or are sufficiently cautious about such major purchases to seek professional advice if disclosure statements are available prior to purchase. Thus, although certain of the proposed order provisions in the Commission's consent settlement with CSI deal with misrepresentations, the primary thrust of the remedies is to insure that there is adequate disclosure of the risk involved in the transaction, especially financial risks.

We found that in many instances elderly retirees had been induced by CSI to enter into binding life care contracts relating to life care homes which were, at the time of sale, already insolvent and, in some instances, on the brink of bankruptcy. Prospective residents allegedly not only were given little pertinent financial data relating to the life care homes but uniformly were assured that the financial conditions of the homes were sound.

Representations relating to financial soundness go to the heart of the promise of lifetime security essential to any life care contract. Consequently, the Commission imposed three separate provisions in its order dealing with the subject. The order prohibits any representations that there is little or no financial risk involved in any life care contract marketed by CSI. It also requires, as part of a disclosure statement, an affirmation that entering into a life care contract may involve significant financial risk. This provision also advises prospective residents to seek advice from an attorney, banker, or other adviser who is independent from respondents and the life care home. Perhaps the most important provision in the order is one that requires disclosures of meaningful data which will enable prospective purchasers to determine the security of their investments. It requires respondents to provide prospective purchasers with specified detailed financial statements regarding the life care home. While the information may be in a form somewhat difficult for an untrained person to digest and make sense of, the 5-day minimum precontract period will give a prospective purchaser time to consult a knowledgeable financial adviser for interpretation and advice.

ROLE OF MORTGAGE LENDER

CSI, through printed advertisements and in-person sales pitches, exploited the name of its largest well-known institutional mortgage lender to give the impression that the investment was safe. A few prospective residents allegedly were told by CSI sales representatives that the mortgage lender actually guaranteed the life care contract. Other residents relied on the fact that the mortgage lender would not put its money in the venture unless it were safe. Of course, the mortgage lender's interest in the life care home is protected by a mortgage on the physical premises, and so its

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ee, dated Oct. 15, 1979, leaves no doubt as to the trustee's view of the nature of those operations: "For more than 25 years, Pacific Homes perpetrated a fraud on unsuspecting elderly people in the name of the Methodist Church. That fraud, which consisted of taking money in exchange for the promise to provide lifetime care, but then diverting that money for the payment of current obligations instead of reserving those funds for the future costs of that care is best characterized as a modern day 'Ponzi' scheme." Report of the trustee at page 1.

risks are not coextensive with those of the residents who have no liens or indeed even any property rights in the homes.

In this regard, the order prohibits respondents from representing that any mortgage lender insures the economic security of the life care home covered by the mortgage. It requires an affirmative statement explaining that a resident's interest provided by the life care contract is subject and subordinate to any mortgage on the life care home, or the interest of other creditors occupying a preferred status, if such is the fact.

SERVICE FEE INCREASES

It appeared that many prospective residents were told by respondents that monthly service fee increases at life care homes marketed by them, if necessary at all, would be limited by increases in social security benefits over the same periods of time. In fact, many CSI-related homes were forced to raise their monthly service fees dramatically in order to avert economic collapse. In these instances monthly service fee increases exceeded corresponding social security increases. It is not our position that service fee increases are necessarily undesirable. Indeed, sound fiscal policy may dictate that, unless this fee is allowed to fluctuate to compensate for inflation, a life care home may be doomed to economic collapse. However, prospective residents should not be deceived and should be apprised of what is asked of them financially before they enter a life care arrangement. The order prohibits representations that monthly service fee increases will be limited by social security increases, unless such is the fact.

RESERVE FUNDING

We concluded that respondents led prospective purchasers to believe that the life care homes marketed by them maintained sizable reserve funds to provide for the future services promised residents and for the economic survival of the homes. In fact, there were reserve funds, but often they were established for the purpose of protecting the mortgage lender's interest. The mortgage lender had the unilateral right to waive reserve fund requirements, and on occasion did so. Residents interviewed by our staff appeared more confused by this issue than any other. The fact of the reserve fund was used as a selling point, and was important to them. What the reserve fund consisted of, and its purpose and limitations, was, however, a mystery to most residents. The majority believed it was somehow tied up with guaranteeing nursing and other health care.

The order prohibits respondents from representing that any life care home has established reserve funding which insures the home's financial ability to perform under life care contracts, unless such is the fact. Another order provision requires an affirmative statement describing the nature of any reserve funding. The statement must disclose the circumstances under which the fund may be depleted by the life care home, the mortgagee or other parties. Where no reserve fund exists, this fact must be disclosed.

RELIGIOUS AFFILIATION

CSI, through direct and indirect means, falsely implied a religious affiliation for many of the life care homes marketed by them. The implication to some prospective residents was that some religious denomination stood behind the homes, and had a legal and/or moral responsibility for their debts and obligations. For some other residents, it served to lower their guards in considering the purchase of a life care contract, causing them to look into the transaction less carefully than otherwise would be warranted by the very size and importance of the investment.

The order requires respondents to cease falsely representing the religious affiliations of life care homes marketed by them or from falsely implying that any religious group may have any legal or moral responsibility for the fiscal integrity of the homes. The order also requires disclosure of the religious affiliations, if any, of the life care homes being promoted, and a description of the extent to which any religious organization may be responsible for the financial or contractual obligations of the life care homes.

USE OF PREPAID ENTRANCE FEES

As a convenient way to raise money for some of its life care homes, CSI employed a marketing plan whereby prospective purchasers could pay all or a portion of the entrance fees in advance as a refundable deposit to insure a living unit at the home at some future time. The amount of the entrance fee was fixed at the date of deposit

which protected the prospective resident from inflationary forces. Contrary to the expectations of the prospective residents, however, the deposits were not escrowed or set aside in trust but were instead spent immediately for expansion, construction, and current operating expenses. Where there has been a run on withdrawals, no money has been available to pay back these supposedly refundable deposits. The order requires an affirmative disclosure of the intended disposition of such deposits.

USE OF RESERVES FOR UNRELATED PROJECTS

In many instances, CSI diverted revenues derived from entrance and monthly service fees to transactions involving entities not directly related to the specific life care homes from whose residents the money was derived. Prospective residents were thereby deceived in their reasonable assumption that their payments would be used for them and for their home. The order thus requires affirmative disclosure of the disposition of any such revenues used for or to be used in connection with transactions unrelated to the homes.

CONCLUSION

The FTC's action in this matter, of course, binds only CSI and not the industry as a whole. The Commission is hopeful, however, that the affirmative disclosures required by the order will provide beneficial and important information for prospective residents of all life care homes and will serve as a model to life care home operators everywhere. Many of the required affirmative disclosures parallel disclosure requirements of those few States which have enacted laws dealing with life care arrangements (Arizona, California, Colorado, Florida, Maryland, Michigan, and Minnesota). Other order provisions draw on the Model Continuing Care Provider Registration and Disclosure Act developed by the American Association of Homes for the Aging, as well as upon the Commission's own experience in this area. With growing numbers of life care homes either insolvent or in serious difficulty, the Commission believes that this order can play a useful role in providing disclosure guidelines of assistance to home operators and prospective residents alike. To further this goal, the Commission is working in tandem with the American Association of Retired Persons to prepare a multimedia package of information on housing alternatives for the elderly which will include facts about life care homes.

Chairman HEINZ. I want to ask Helen Bishop, before you got involved with the life care community at Alabama Meadows, did you have any apprehensions? Were you nervous in any way about those running it, before you gave up your home?

Mrs. BISHOP. Not really, no, because I thought that I was going to be well taken care of, with all these promises. You should see the bulletins we got, and all the different information that was given to us. I thought it was really a good thing for me.

Chairman HEINZ. What was it that made you think that everything was going to be very, very well run?

Mrs. BISHOP. Well, they were so convincing. You see, I did not see Brother Ballard, the Dr. Ballard that we are talking about. I was interviewed altogether by a Dr. Turpin—I do not know whether you have even had his name brought up or not. But I did all my talking to him. I did not even know Brother Ballard for months; he just did not come up. And I did all my dealing with him. I brought a bond from him.

Chairman HEINZ. You say he was a doctor. Was he a medical doctor, or——

Mrs. BISHOP. No; Dr. Turpin is just a doctor of divinity.

Chairman HEINZ. A doctor of divinity?

Mrs. BISHOP. Yes, sir. He was a Baptist minister.

Chairman HEINZ. Was the fact that he was a minister reassuring to you?

Mrs. BISHOP. Well, not exactly. You know, I pondered over that thing for several months before I ever gave in to it, and I am just a person that—I do not want to ever call on my family.

Chairman HEINZ. Let me ask Mr. Robinson, I have here what appears to be an advertisement from CSI [see appendix, item 5]. It has 20 beautiful pictures of retirement villages that, as you look at the drawings of them, appear to be absolute models of wonderful places to live, beautifully laid out, the grass being always green in each and every instance. What can you tell us about these retirement villages that, apparently, Mr. Berg and CSI claimed to be associated with?

Mr. ROBINSON. Well, I would rather limit my comments to just what is contained in the indictment. But the indictment of Berg alleges that he had those same pictures up on the wall in the lobby of The Meadows. The residents of The Meadows were led to believe that he either owned or operated those places. The grand jury alleges in the indictment that at the time that he was borrowing the money from the people, that he had been kicked out of several of those villages, and that three of them did not even exist.

Chairman HEINZ. Three of them did not exist?

Mr. ROBINSON. Well, he collected some money on them, but he did not build anything.

Chairman HEINZ. I understand what you mean.

Now, here is another—I guess it is an ad—that says, "A high-paying, short-term investment, Dr. Kenneth Berg expects to assist in building 800 lifelong retirement centers throughout the Nation to help house the 80 million elderly within 10 years" [see appendix, item 6].

Was this the subject of any indictment by the grand jury?

Mr. ROBINSON. No, it was not. That is an advertisement that he allegedly ran in the newspapers throughout the State of Nebraska, and it really does not have any part in our indictment of him, although it was something that we ran across.

Chairman HEINZ. As far as anyone can determine, though, he was a little short on breaking ground for that many?

Mr. ROBINSON. I am afraid so, yes, sir.

Chairman HEINZ. Very well.

Now, in view of the problems that Alabama has experienced with life care, does your office, that of the attorney general, intend to propose any State legislation on this subject?

Mr. ROBINSON. We have talked about it very briefly. The main thing we are concerned about now is the upcoming trial. But one thing that we have talked about is the possibility of amending the securities laws to include a life care contract in the definition of a security. Another thing that we have talked about is the possibility of——

Chairman HEINZ. Could you hold on at that point. That is an interesting point, to treat a life care contract as a security.

I have here a life care contract signed by Dr. Kenneth Berg [see appendix, item 7]. It is pretty hard to read because it is all in his handwriting, as far as I can tell, and it appears to be somewhat casually drawn. Yet, the applicant who signed this, a husband and wife, based on this contract, committed $37,000 to CSI. Nowhere on it can I find exactly what it is—maybe it is because I cannot read

people's handwriting—what it is that is being agreed to between the parties and particularly what the village—in this case, Christian Services, Inc.—specifically intends to provide to the residents.

Have you seen such contracts?

Mr. ROBINSON. Yes, sir, I have, but I would rather not go into it, because that will probably be something that will come up at the trial, and I would rather not comment on that at this time.

Chairman HEINZ. With respect to the idea of making contracts subject to securities regulation—if you go out, and you buy $5,000 worth of securities from an offering, chances are, at least if it is a new issue, your broker is going to give you a prospectus—you will probably get one from him whether you buy or not—and you read it, and from it you learn certain things. And the average American is going to read something pretty carefully before they put $5,000 or $10,000 into it.

Mr. ROBINSON. It will not only require a certain amount of disclosure, but it will also enable the Securities Commission to regulate the people who are selling these things, to check their past history, give them some kind of test.

Chairman HEINZ. Now, you started to make a second suggestion before I interrupted.

Mr. ROBINSON. One thing that we have talked about is the possibility of enacting a criminal statute which would make it a felony for an owner, operator, or manager of a retirement facility, a nursing home, or any kind of life care facility to enter into any kind of financial transaction with a resident of a home over some nominal amount. That sounds like a pretty harsh remedy, but based on what we have seen, these people who live in these homes, especially the ones that are marginal, are so dependent upon the people who own or manage them, and they have got to have so much trust in these people. You enter into almost a kind of mind control situation. Plus, a standard practice in the life care industry is to get a financial disclosure statement from each resident, showing what kind of assets they have, where they are at, and it is just wide open for abuse, as we have seen.

Chairman HEINZ. Now, you have been investigating Dr. Berg and his operations for over a year. What can you tell us about his assets, his financial worth, when he was at his peak, his zenith, and what can you tell us about those assets now?

Mr. ROBINSON. I would like to respond very briefly to that, because I think I am getting on thin ice talking about that too much, but I think at one time, he had a substantial amount of assets, and it is his contention that he does not have any assets now, and that is the reason he cannot pay all these people off.

Chairman HEINZ. Was it alleged at any point, or did you receive any information at any point, indicating that he had income well into six figures?

Mr. ROBINSON. Well, public documents that have been filed indicate that he filed financial statements—we have several of the financial statements—some of them showing assets anywhere from $12 to $17 million net worth, and at a point in time when he was going to people who were 80 years old and asking them to loan him money with no collateral.

Chairman HEINZ. Well, according to a balance sheet that Dr. Berg filed, he lists his assets as in excess of $17,779,000 [see appendix, item 8]. Most of his assets appear to be pieces of property adjacent to one of his facilities. And yet you are saying that today, he claims he does not have any money.

Mr. ROBINSON. Can you tell me the date on that?

Chairman HEINZ. Yes. The date on this is August 10, 1981, and there is a signature of the Valley National Bank on it. Exactly what that means, I do not know.

Mr. ROBINSON. Well, at that point in time, Dr. Berg owed a lot of money to people in a lot of different places and could not pay them, or would not pay them.

Chairman HEINZ. Well, if there is any truth to the statement, it would be an understatement to call this, "Easy come, easy go."

Mr. ROBINSON. Yes, sir. I think that pretty well sums it up.

Chairman HEINZ. Commissioner Bailey, we understand you found that Dr. Berg had set up his books on a somewhat creative system, a creative cash accounting system. Could you explain what you learned from his accounting practices and what the effect of those practices were?

Commissioner BAILEY. Basically, the system that he was using was called the cash system, originally, where he showed up-front for the years that endowment fees came in, those fees as a cash balance, or the worth of the home. The method that he will be using from now on is called an accrual method, and that pro rates out over several years the amount of the endowment as a more realistic way of projecting the worth and the outstanding liabilities, and so on.

But what happened was, when you changed the method in the case of one home, it originally showed the worth of the home as $24 million, or something in that neighborhood, in the black. When you change the system, within 24 hours the home is $8 million in the red. So it makes a substantial difference to do it differently. Now, I am not an accountant, and so I cannot be very much more clear than that. And at the moment, as someone else said earlier, Senator, there is as yet no established accounting method for these homes. While there is a board of accountants that establishes a generally accepted accounting method to be used for a variety of different bookkeeping things, there is none for this industry right now.

Chairman HEINZ. Well, clearly, if you use a cash method, and you are taking these large initial payments and treating them as current income against rather modest current expenses, you will get a very distorted picture of what the actual finances of one of these institutions are. As you point out, one would expect normally that they would use an accrual system where expenses and the income that is reserved against them would be essentially matched over time, but that is not what happened here.

Let me ask Mr. Whitlock, your investigation discovered that the Prudential Insurance Co. had provided Dr. Berg with much of his mortgage money. Could you explain what you know about that relationship?

Mr. WHITLOCK. Could you clarify that, Senator? It is true that Prudential provided $106 million to Dr. Berg's organizations—some 21 of them, I think——

Chairman HEINZ. It sounds like they got taken in, too.

Commissioner BAILEY. Let me just add to that, if I could. Yes, that is right. Prudential was the mortgage lender. And the problem for the residents, the misrepresentation involved, was that CSI or Dr. Berg indicated by some of his ads that Prudential, being a well-known and well-respected member of the insurance business, that the homes were backed by Prudential. They even, apparently, had some salesmen who were saying to prospective residents that Prudential guaranteed their entrance fee or endowment fee whereas, in fact, Prudential was simply the mortgage lender. And I will say when Prudential found out that those statements were being made, and the ads were being run, they took steps to stop it immediately.

Chairman HEINZ. I understand that Prudential has acted above and beyond the call of duty here.

I think the significance of the relationship with Prudential, "The Rock," is twofold. First, their willingness to lend mortgage money was a great assist to what appears to be a sales scheme. They did not dwell on the actual details of the relationship with great care, and certainly some inflated the nature of the relationship all out of proportion to what it was, and therefore traded off on the reputation of the Prudential Insurance Co. Second—and this is, to my mind, even more significant—the fact that as sophisticated a lender as the Prudential Insurance Co. got taken in, suggests that if they can get taken in, everybody can be taken in by an unscrupulous operator.

Commissioner BAILEY. Well, there is surely truth to what you say. I would say that one of the further problems that may arise—and I do not know anything about the internal operations or anything about Prudential's decisions—but there has been a lot of talk this morning about the sources and availability of funds for nonprofit organizations of this kind, the need for money from time to time, how to insure them, what to do. And one of the dangers, it seems to me, that could arise from this kind of situation is that other institutional lenders, knowing what has happened, at least, in the case that we know about, might be reluctant to provide the very funds that surely are going to be needed if this industry is going to grow.

Chairman HEINZ. I do not know whether I should ask you this, Pat, or attorney Whitlock, but your jurisdiction is limited to for-profit business enterprises, as I understand it.

Commissioner BAILEY. That is correct.

Chairman HEINZ. How does that affect your ability to do rulemaking for the life care industry?

Commissioner BAILEY. Well, very seriously, adversely, I would say. Even if we were otherwise inclined or had some reason to believe that a rulemaking would be appropriate in this case, it is true that almost all of these communities are nonprofit, and if that is a correct description of their actual operation, then the Federal Trade Commission has no jurisdiction over them and cannot therefore even investigate them.

About 33 percent of existing life care homes are managed by for-profit corporations like CSI, and those, we can look at. We can at least look at the for-profit, proprietary managers. But that would mean that we cannot investigate, we do not know what is going on and have no way, really, of finding out, in the 65 percent of the industry that is not related to a for-profit manager.

Chairman HEINZ. Now, regarding the consent decree with Berg, why doesn't that settlement not require those who unfairly profited to compensate those residents who may have been defrauded, like Mrs. Bishop?

Commissioner BAILEY. Well, part of the reason, the general reason, that that would not be the case is that the contract manager might not be the repository of any available funds; it might be the nonprofit corporation—which the FTC could not reach. If the for-profit manager had funds available for that purpose, that would be a different story, but we had no evidence that there were funds available for redress in this instance.

What we try to do in a case like—well, this is the only case we have had like this—but in general, we try to provide redress to people out of funds that are available, if there are any.

We have to recognize, however, that in this industry, what we are talking about is bankruptcy, and when that is the case, there is going to be very little redress available.

Chairman HEINZ. Well, I want to commend you and Mr. Whitlock. Mr. Whitlock, I understand, has done just an enormous amount of work on this issue. I know you have to do work on many, Commissioner. I think he has made a really excellent investigation, a pioneering investigation with your report on the life care industry and Dr. Berg. His services have been of great value to this committee.

I think it is worth noting that I have consciously structured these hearings into two panels, one, where we found out the good news about life care, and the second, yours, where we found out some of the bad news. Clearly, there are tremendous opportunities in life care, and it would be a tragedy, in my judgment, if we allowed the kind of things that Dr. Berg and others have been alleged to do to ruin the reputation of this industry.

I personally have tremendous confidence that if we can find, as a Nation, the way to address some of the great potential for abuse and even fraud, that if we address those properly and intelligently, that life care can be a tremendous asset to literally millions of senior citizens instead of, as it proved to be for Mrs. Bishop, a tragedy.

Commissioner BAILEY. There is no question about that. We are thinking now about what further we can do. One of the things we are doing right now is working with the American Association of Retired Persons to put together a package of media, including booklets and visual aids, that they would distribute to their 5,000 centers around the country to get information to the people about the alternatives for retirement living, which would include a specific segment on what to look for in the life care industry to be sure, to the degree you can be sure, that you will not be getting into trouble when you enter one.

Chairman HEINZ. I commend you on that effort. It is a worthwhile one. It will not be easy to do it, but you will not know how easy or hard it is until you try and get it out.

Are there any other comments at this point from the panel?

[No response.]

Chairman HEINZ. If not, I just want to note that Dr. Berg has been permitted an opportunity to make a 5-minute sworn statement before the committee.

Is he present in the room at this time?

[No response.]

Chairman HEINZ. If not, the committee is adjourned.

[Whereupon, at 12:02 p.m., the committee adjourned.]

APPENDIX

MATERIAL RELATED TO HEARING

ITEM 1. STAFF MEMORANDUM PROVIDING BACKGROUND INFORMATION ON LIFE CARE INDUSTRY

TO: Committee LA's

FROM: John Rother/David Holton

RE: Hearing May 25, 1983 Life Care Communities: Promises and Problems

DATE: May 23, 1983

On Wednesday, May 25, 1983 at 9:30 a.m. the Special Committee on Aging will convene a hearing entitled "Life Care Communities: Promises and Problems" in room 385 of the Russell Building. What follows is an overview of information related to this hearing.

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PREFACE

One of the most serious problems facing elderly middle class Americans is how to assure that their future housing and health needs can be met with the resources they have available to them in their retirement. Many are concerned, and rightly so, that increased longevity and increasing costs of nursing home care will conspire to destroy their independence and force them to "spend down" to poverty levels.

Many older Americans are turning to the concept of "life care" to address this concern. Life care is the concept whereby an individual, through a contractual arrangement with a life care facility, agrees to pay an entrance "endowment fee" and a monthly "service fee" in return for a place to live and for nursing care for the duration of the individuals life. These facilities are sometimes referred to as CCRC's -- Continuing Care Residential Communities.

In response to this increasing interest, we are witnessing rapid growth in the life care industry. This growth unfortunately has been marred by a troubling number of business failures and bankruptcies. When these occur, elderly residents who have invested their life savings can be left destitute.

LIFE CARE INDUSTRY CHARACTERISTICS

Life Care Defined:

Life care is the concept whereby an individual, through a contractual arrangement with a life care facility, agrees to pay an entrance "endowment fee" and a monthly "service fee" in return for a place to live and for nursing care for the duration of the individuals life. Endowment fees range from $20,000 to $100,000, while service fees, which usually have some form of cost-of-living escalator built-in, range from several hundred, to several thousand dollars per month. For these fees the resident is typically entitled to lifetime use of a living unit, utilities, meals, various services and amenities and guaranteed lifetime nursing care (exclusive of hospitalization). The living unit, services and nursing care are usually provided at a single complex containing numerous living units which may range from single apartments to duplexes or even detached houses.

Life Care Residents:

Elderly middle class Americans seeking security against the future seem most attracted to life care. Commonly, the prospective life care resident is one who has owned his or her own home. Upon reaching retirement age, he or she decides to give up the responsibilities of maintaining a home and the money realized from the sale of the home may constitute the principal portion of the entrance fee for the life care contract, and may well represent the bulk of the individuals life savings.

Growing Industry:

Reliable data on the size of the life care industry is scarce. Nevertheless, depending upon definitions used, most observers agree that it is extensive and growing with at least 300 to 500 facilities in existence, housing some 100,000 residents. Revenues are projected to be approximately one billion dollars per year.

Very few life care homes are totally proprietary although there is a growing interest in this industry by the for profit sector. Today, one-half to two-thirds of the life care homes are non-profit, while at least 33 percent of the homes are managed by for profit contract managers.

Advantages:

Those who support this concept argue that life care represents an attractive alternative for a potentially large number of older Americans. These proponents claim that people in life care communities are hospitalized less frequently and live longer than their cohorts who do not live in life care facilities. They maintain that life care offers individuals a kind of self financed insurance that will protect them against loneliness, boredom, social and physical isolation and inactivity; financial independence with the assurance that dependence upon government support will never be necessary; a predictable system of pre-paid personal care, in-home health care and nursing care; and overall, the assurance that one will be able to remain independent for the greatest length of time possible. Those who support life care are convinced that it is a concept that time has come and it can be of value to million Americans and that public policy should support this industry's growth.

Robert B. Haldeman, a Baltimore attorney with experience in life care work provided an excellent example of how the economics of this type of system can work to an individuals advantage:

> "The economics of congregate living may be illustrated by an example of a vice president of a large bank who came to the executive director of one life care facility and said, 'My mother is ninety-four. She needs to come into your personal care unit. Should I get a life care contract and pay $12,000 for her life care or should I pay a monthly rate of $1,200 per month?' The monthly rate if she is in a life care contract was about $500. Well, he was encouraged to take a life care contract. He decided based on his economic forecasts that Mom was 94 and he would not go the life care route, but, instead, go the monthly rate.
>
> "Mom died at 106. So much for those forecasts. The difference to him in dollars, which are not discounted to present value, was about $89,000 over the period. Now, it is that $89,000 of cash which is being risked in the risk pool, and each of the elderly people who come into life care are expecting to get sick, in effect, like buying an insurance policy, and they are trying to

say if I get sick I am going to be taken care of at the lowest cost. If I don't get sick, I am going to pay something which is within my means to get that protection.

"In the contracts, the basic financial payment terms that are being taken into account are the entrance fee and the monthly fee. The entrance fee, together with any surcharges, is that portion of the fee which really takes the major risk of morbidity -- that is, people guessing that they are going to have a lot of sick days before they die. And the entrance fee is an attempt for the facility to guess actuarily what will take care of the total community. The monthly fee generally is adjusted to take care of changes in general costs. . . ."

Profit Interests

Traditionally, life care communities have been established and operated by non-profit, generally church related entities. Even this type of generally altruistic operation has had problems of inept management, mismanagement and fraud. Recently however, increased interest in life care has been observed in the for profit side of the economic community. As a recent article in Real Estate Review noted:

"The development of nonprofit life care communities creates business opportunities for real estate professionals. The promise of substantial tax benefits enables developers and investors to develop such communities at minimal cost to the nonprofit sponsors. Architects, building contractors, mortgage companies, health care consultants, interior designers, advertising, marketing and public relations agencies, and others have also found new opportunities in life care communities."

The article goes on to sight the Open Door Estates of Philadelphia, Pa. as an example of successful interaction between the non-profit and for profit sectors. Ironically, the operator of this same facility, just two years later, became embroiled in allegations of fraud, profiteering and misrepresentation.

Current Research On Life Care Industry:

In April 1981, the Wharton School of the University of Pennsylvania was awarded a research grant to perform a comprehensive analysis of Continuing Care Retirement Communities (CCRCs). The study was funded with grants totalling $289,676 from the Robert Wood Johnson Foundation and the Commonwealth Fund. The American Association of Homes for the Aging strongly endorses this study. The project director is Howard E. Winklevoss, Ph.D., associate professor of Insurance at the Wharton School, who has been conducting actuarial research in this field for the past seven years.

The University of Pennsylvania research staff has been assisted by an advisory committee consisting of thirteen individuals whose primary functions are to advise the research staff on the contents and conduct of the study, to respond to the study's findings and analyses as they

emerge, and to assess their implications for the policy, practices, and future viability of the continuing care retirement community concept. The advisory committee is chaired by Mr. Robert M. Ball, a former Commissioner of the Social Security Administration and the first administrator of the Medicare program. The other members of the advisory committee were selected to represent both providers and residents of CCRCs and a range of specialists in various fields related to continuing care. These fields include medicine, nursing, law, accounting, economics, and insurance.

ADVISORY COMMITTEE

Robert M. Ball, National Academy of Sciences; Dale Neuhaus, Ernst and Whinney; Doris Schwartz, University of Pennsylvania; Walter Shur, New York Life Insurance Co.; Dr. Bruce Vladek, New Jersey Department of Health; Dr. Stanley S. Wallack, Brandeis University Health Policy Consortium; Dr. T. Franklin Williams, Monroe Community Hospital; and the following AAHA members: James W. Carter Jr., Presbyterian Homes of the Synod of Florida; David C. Crowley, AAHA executive vice president; Hon. Thomas M. Jenkins, Superior Court of San Mateo County, Calif., Lloyd W. Lewis, Kendall at Longwood, Pa.; Donald L. Moon,, Foulkeways at Gwynedd, Pa.; John A. Murdock, Health and Welfare Ministries of the United Methodist Church.

The three research objectives of the study are: 1) to define the universe of CCRCs and establish a nationwide data base on their financial and operating characteristics, 2) to develop actuarial/accounting procedures for setting fees that will help ensure the long-term financial health of CCRCs, and 3) to examine the legal issues arising from the nature of the continuing care contract.

Representatives who participated on this research project will testify at the committees hearing.

Appendix 1 excerpts Chapter 13 of the Study Commission's report, and summarizes their general findings. This is an important document and should be read carefully.

Appendix 3 provides a partial listing of life care communities by state.

EVIDENCE OF A PROBLEM

For some time the Committee has been receiving evidence of problems in the rapidly growing life care industry.

In August of 1981, the Committee convened a field hearing entitled "Frauds Against the Elderly". That hearing resulted in a number of actions including the development, design and completion of a major national survey on the subject of consumer fraud and the elderly. The first survey of its kind asked a national sample of law enforcement and consumer protection specialists about their experience with fraud and its impact on the elderly. Released at its February 1983, Washington, D.C., hearing entitled "Consumer Frauds and Elderly Persons: A Growing Problem", the survey uncovered the fact that the elderly are increasingly the targets and victims of frauds. A list which ranked the ten frauds which are most harmful to the elderly was developed. Nursing home frauds, which for the purpose of the survey grouped nursing home and life care communities together ranked seventh.

As an additional byproduct of the survey, respondents were asked to furnish the committee with examples of additional serious consumer related problems they thought might be of interest to the committee. On November 25, 1981 Sergeant Jack Bishop of the Mobile Alabama police department wrote saying:

Complaint: Bankruptcy:

"Attached is the questionnaire relating to consumer problems and economic frauds against the elderly which you requested from Chief Orr for your committee's investigation. You have asked for personal-experience input into this project. It cannot get much more personal, as my own mother was involved in the swindle of the Alabama Meadows Retirement Village. . . .almost from the beginning.

"The State of Alabama has taken the retirement settlement into receivership and is in the process of selling the settlement to a Dr. Kenneth Berg, who has defaulted on payments, yet still has control over the old folks living there. Yet these same old people, who have a vested interest in the settlement, do not have a voice in the operation of the settlement. When Dr. Berg became administrator, he drew up a new contract specifying numerous benefits. Shortly after the members (including my mother) signed the new contract, a letter was sent out by the State Conservator, Mr. Robert Denniston, cancelling various provisions of the contract.

"My mother is so discouraged, she is losing spunk and her will to fight. The new so-called owners have caused her and others to experience out-and-out harassment. We have no place to turn for

help. Neither the local District Attorney nor the State Attorney General will act on this matter. Our only recourse is to retain a private attorney, which will further add to the expenses. (My mother had already given her house to the Rev. Mr. Ballard for the so-called 'lifetime' care.)"

What follows are excerpts from correspondence received in recent years by the committee and its members. These letters of complaint are indicative of many of the problems associated with life care.

Complaint: Increasing Monthly Fees

In another letter to a member of the committee, the nephew of a woman entered a life care facility and then found that its bankruptcy and the consequent increasing monthly service fees were outstripping her ability to pay. The resident committed suicide shortly after receiving the last in a series of price increase notices. The letter reads in part:

"Recently my Aunt Ursula Goubeaux, a resident of the Brethern Home in Greenville, Ohio, apparently ended her life by drowning in the small pond behind the Home (second life lost in a pond unguarded by fencing).

"She was a resident for approximately six years and purchased a sealed life time contract with her life savings.

"The Home through poor management, rapid building expansion and inflation soon found itself in financial trouble and took bankruptcy about two years ago. The residents were informed they would be subject to an additional monthly rate above the price of the original lifetime contract. Of course this news added to the despair and depression effect on many of the residents, I am sure.

"A monthly rental notice to be effective June 1, 1979 was distributed in early April 1979 to the residents, and my Aunt took her life on April 12 1979.

"It seems to me injustices and rights are being violated on our elderly in many retirement homes, and possibly need monitoring and guide lines to abide by, whether by State or Federal level. Life Contracts should be out.

"Perhaps in a way Congress reviewed and studied the Private Pension System, they could focus on the Retirement Home Industry. . ."

Complaint: Insufficient Refund

In yet another letter, J. Nussell Noll of Feasterville, Pennsylvania wrote a letter expressing his frustration with the high cost of nursing home care and recounting his experience with a life care home. His letter reads in part:

"1. Standard Procedure in all nursing homes.

"2. Those on welfare have no worry and have everything paid for them so at least some if they get in a fairly decent home are lucky.

"3. Those who are considered middle class people and never been on welfare or what have you. They have to pay $1,000.00 a month, and are soon out of money.

"4. Now about these new Total Care Homes -- 90 days to make up your mind where you get your money back.

"Our Aunt Bea paid $42,000 to get into one of the Total care homes and after nine months died. Her family received not a penny of that money back.

"Had she not died, but just changed her mind about staying she would have received money back. This is robbery.

"In our area Total homes are sponsored by various Churches, and so are non-profit, are springing up like mushrooms.

"Aunt Bea sold her home for $60,000 and may have had a small pension, and social security pension, so with her savings may have had $80,000.

"Also, you pay $300 a month for single person for meals and etc., $500 or $600 for a couple. You must know they will sell her apartment, $42,000 to $50,000 if a couple. Non-profit.!!"

Complaint: Inadequate Disclosure

A Columbus, Ohio attorney contacted a Committee member's office with a complaint about a life care community.

His letter illustrates the problems that residents and their guardians can have in dealing with a facility that is locally owned by respected community leaders but operated by an outside management firm. The facility with which he was concerned also happened, coincidentally, to be managed by Life Care Services Corporation, a one-time investigation target of the Federal Trade Commission. His letter reads in part:

"I have no reason, based upon my investigation to date, to believe that the expressed meritorious purposes of this facility, known as Friendship Village of Columbus, Ohio, is subject to any question. I certainly do not intend to raise any suspicions regarding the non-profit entity which owns the facility or the corporate entity, Life Care Services Corporation, which I understand has been engaged to operate the facility. Certainly, the respective individuals who are members of the Board of Trustees of the non-profit corporation (known as Friendship Village of Columbus, Ohio, Inc.) are highly respected and well-meaning individuals in this community. I am confident they have associated with the facility for the purposes of community service. I understand that the promoter, contractor and operator of the facility is a corporation known as Life Care Services Corporation, located in Des Moines, Iowa.

"My concern arose because of the skimpy information that appears to have been made available to my client in entering into a residency agreement. Substantial sums of money are involved and in addition the typical 'resident' is an elderly person who is a member of the general public that deserves some protections against unscrupulous operators or promoters. It appeared to me that certain disclosure requirements should be required, similar in nature to the type of information that would be disclosed to members of the public under the Securities Act and/or Regulations and Rules of the SEC in the same manner as if they were investing in a security. The Residency Agreement appears to me to be much in the nature of an investment contract. I am enclosing a copy of the particular Residency Agreement (and Addendum thereto), which is used by Friendship Village of Columbus. I have blocked out certain portions in order to retain the anonymity of my particular client. I am also enclosing a portion of a brochure which apparently is also made available to prospective residents.

"In this particular instance, we sought financial information regarding the non-profit corporation and were furnished with a balance sheet and statement of operations which was several months old at the time. It was a computer type financial statement print out, prepared during the construction of the facility and it was difficult to glean any significant information from this balance sheet.

"We were unsuccessful in obtaining any financial information regarding the contractor and purported operator of the facility, which we understand is Life Care Services Corporation from Des Moines, Iowa.

"Several months ago, I orally requested from one of the trustees the financial information which he had available on the operator. To date, I have not received any information. I do understand that Life Care Services Corporation operates a number of such facilities across the country. The number 17 sticks in my mind.

"In my particular instance, my client has substantial means and, in my opinion, could absorb the entire loss of the investment in the Residency Agreement. However, I doubt this is true in the majority of the cases.

"Another concern I had was the description of the services to be provided. As I stated before, the proposed resident is an elderly person, easily influenced by a 'sales pitch,' hesitant about asking too many questions and normally making a significant change in his or her life style at the time of entering into such an agreement.

"Another concern is that proposed facilities to be built do not afford the prospective tenants an opportunity to inspect and observe the operations.

"Another concern is that the disclosure of any risk involved is naturally not emphasized by the non-profit corporation. While I doubt whether this particular project will have any financing problem, I think this is a real risk that should be fully understood by any prospective resident. I certainly cannot expect any promoter to emphasize these risks unless he is required to do so because of some federal or state regulation. . . ."

Other Problems:

The industry's growth has not been without its share of problems. Many life care communities have gone bankrupt and others appear to be not financially sound. In some cases these were due to short sighted and inept management, in others they were due to deception and outright fraud. Typically these operations get into financial trouble when current operating expenses get too high. Reserve funds, which should only be used to retire long term debt, have been utilized to make up any shortfall.

Other problems have surfaced in this industry as well. For example:

o Residents of life care communities are given no equity interest in the facility. When bankruptcy occurs, the senior citizen residents have no standing and lose all of whatever they have paid in to the home.

o Many life care communities are financed as real estate ventures with endowment fees being used to cover initial construction costs. Reserves are either not established or they are set too low to cover future needs.

o Some life care communities are not actually sound and projections of future revenues and costs are incorrect.

o Some homes use a "cash" accounting system rather than an "accrual" system thereby grossly inflating their cash position and misrepresenting their solvency.

o Some life care communities represent themselves as being affiliated with a religious denomination or church, giving the impression that those entities would back the operation if any serious financial problem should develop. Quite often this claim has turned out to be false.

o Some contracts are written in such a way that if a person decides, even within a reasonable period of time, that he or she does not want to stay at the facility, the entire endowment is lost and not returned even on a prorated basis.

o Instances have occurred where residents have not been told that the operating company was paying inflated prices for goods and services it purchased from other related (non arms length) corporations.

When life care communities get into financial trouble they frequently end up declaring bankruptcy. The FTC notes in a recent report:

> "Staff does not have a complete list of bankruptcies in the industry although many are known to have occurred, particularly in Florida, during the early 1970's. Because bond sales had been used as a financing tool for many of the homes in Florida, the Securities and Exchange Commission opened a number of investigations. Within the last few years, one-third of the homes in Michigan were reported to be in bankruptcy, including Michigan Baptist Homes Development Corp. (Ann Arbor, Grand Rapids, St. Jospeh); Calvin Christian Retirement Home (Grand Rapids); Barcham Hills Retirement Center (Madison); and Jarvis Acres Retirement Community (Devondale). In addition to the major bankruptcy of Pacific Homes, the following homes (or their predecessors) went into bankruptcy: Harvard Village (Skokie, Ill.); Westminster Manor (Austin, Texas); Tresvant Manor (Memphis, Tennessee); John Knox Village (Tampa Bay, Fla.); Baptist Village (Pompono Beach, Florida); and John Knox Village of Central Florida. The following homes managed or formerly managed by CSI are believed to be insolvent or in serious financial difficulty: John Knox Village of Lee's Summit (Mo.); John Knox Village of Michigan (Ann Arbor); John Knox Village of West Texas (Lubbock); Sunny Acres Villa (North Glenn, Co.); and Medalion Homes (Colorado Springs, Co.)."

Quite frequently these bankruptcies result when current operating expenses become too high and cash reserves which should be held for future needs are drawn upon. In instances like these the corporation is essentially feeding on itself.

Pacific Homes Bankruptcy:

The problem with this kind of scheme to raise money was demonstrated in 1977, when Pacific Homes, a chain of California life care communities sponsored by the Methodist Church, filed for reorganization under Chapter X of the Bankruptcy Act.

Pacific Homes was a California based non-profit corporation, incorporated in 1929. At the time of its bankruptcy in 1979 Pacific provided care to approximately 2000 residents in a total of fourteen facilities. Ten of these facilities were located in California, two were in Arizona and two were in Hawaii. All were life care facilities.

At the time the failure of Pacific Homes was the largest failure of its kind in the life care field. Thanks in part to the excellent and conscientous work of the bankruptcy trustees, their report on the Pacific Homes case has become a kind of classic -- helpful in understanding what can go wrong in a life care operation. It should be read in full by anyone hoping to grasp the sometimes unplesant realities of failures in this industry. (A copy is maintained in Committee files.)

Pacific Homes was no fly-by-night operation. It had its roots in the German Methodist Conference that established a home for retired ministers at a campground, now the site of Kingsley Manor, in Hollywood in 1912. In 1928 the German Conference merged with the Southern California Conference of the Methodist Episcopal Church, and in 1929 the Pacific Old Peoples' Home was incorporated as a California nonprofit corporation. Kingsley Manor was the only property operated by the corporation until 1949. Presumably the success and ambiance of these communities for ministers and missionaries had appeal and application to the wider church population and the growing number of people who retired to southern California.

From 1949 to 1964, six additional properties were acquired by the corporation which came to be known as Pacific Homes Corporation. Pacific Homes historically operated its business on the basis of prepaid life-care contracts which essentially promised residents lifetime care, including comprehensive health care services. Residents paid an "accommodations fee" to cover the cost of the residence and a "life care fee" designed to cover the cost of health care. In later years, Pacific Homes continued to grow and also entered in continuing care agreements which included an accommodations fee and a monthly care fee.

Robert C. Neff, a Newark, New Jersey attorney, in commenting upon the troubles of Pacific Homes said: "Let me read you an advertisement that The Wall Street Journal found particularly appropriate in an article which it published on the subject of life care.

> "'Retire from inflation at any of seven homes. Delicious meals, medical care, superb facilities for recreational and cultural

activities and a lifetime lease on a modern apartment or a cottage, all provided through fees that can never be increased during your lifetime.'

"That advertisement was placed, along with references to a national church organization. The sponsor of that community was a fifty-six-year-old $40 million organization, which had a national reputation (and is now in receivership) it is a tragedy."

The Pacific Homes bankruptcy affected nearly 2,000 elderly people and is the largest collapse in the industry to date. Page one of the Trustee's report leads with the startling lines; "For more than 25 years, Pacific Homes perpetrated a fraud on unsuspecting elderly people in the name of the Methodist Church. That fraud, which consisted of taking money in exchange for the promise to provide lifetime care, but then diverting that money for the payment of current obligations instead of reserving those funds for the future costs of that care is best characterized as a modern day 'Ponzi' scheme."

See appendix 2 for the full statement by trustees detailing specific causes for this failure.

Ohio: Bankruptcy

The Ohio General Assembly, in November of 1979, released the results of its extensive investigation into the state's nursing home industry. Their final report, "A Program in Crisis" devoted an entire section to life care facilities. The report acknowledged that neither the state, federal government or the Association of Ohio Philanthrophic Homes for the Aging, to which most life care projects belong, could determine how many such facilities there were in the state. Nevertheless, the report noted that "Several problems have developed concerning life care communities; while some represent long-time concerns, others have developed only recently."

The report goes on to say that:

"A facility offering life-care or continuing care typically accepts large endowments or entrance fees up to $70,000 in return for this care. In addition to this lump sum payment, they usually charge a monthly fee. While the majority of these are philanthropic and church-related, others are structured as private, non-profit corporations.

"It is impossible to determine exactly how many of these kinds of facilities exist in Ohio at the present time. Even AOPHA (Association of Ohio Philantrophic Homes for the Aging), to which most life-care projects belong, cannot determine how many of their members operate as continuing care. In addition, there is nothing in state licensure or federal certification law for nursing homes which would indicate that it is part of a facility which offers life-care.

"1. Problems with Life-Care Facilities

"Several problems have developed concerning life-care communities; some represent long-time concerns, others have developed only recently.

"a. Poor Financial Planning

"One of the major problems involving life-care projects has been poor finance planning. While the actions of the sponsor may be well intentioned, some sponsors have lacked the skills needed to manage a project. If proper management, estimates of income, and cash flow projections are not available throughout the history of the facility, the project may well become bankrupt. A trustee's report to the court in a reorganization proceeding of one Ohio life-care facility under Section 167(5) of Chapter X of the Bankruptcy Act noted the following causes for financial losses:

"1) unforeseen high rate of inflation;
"2) building cost underborrowed; (insufficiently financed)
"3) project forced to sell contracts to provide operating funds rather than simply to retire building debt;
"4) church sent residents, not money;
"5) heavy demand of new state and federal regulations on the nursing home causing sizeable expenditures in non-revenue producing areas;
"6) federal and state assistance program funding failed to rise with inflation;
"7) the assumptions which projected contributions were incorrect;
"8) life expectancy projections on residents were shorter than the actual life span, thus there was less income from new endowment fees than was anticipated.

"It is noteworthy that in this financially troubled project 'no evidence of fraud or illegal activities has been discovered as a result of the trustee's investigation'. However, this is small consolation to those whose 'life-care' contracts have been cancelled because of the project's financial demise and points out the necessity of good management and planning.

"The life-care facility usually depends heavily on future 'turnover' of residents and new endowments to provide new sources of capital. This necessitates the use of sound actuarial tables for predicting life-expectancy and hence, turnover. While many facilities use very conservative tables, others are very speculative, e.g., - one project used an eight year life expectancy for all residents regardless of their age upon entrance. Currently, there is no requirement as to the type of actuarial table the facility must use unlike the requirements for insurance companies.

"Another reason that sound management and accurate projections are essential, is that because of the large initial cash influx from entrance fees, no problem will surface until the project is at least seven to ten years old. But at that point, the damage may already be irreversible.

"Another planning problem is that many of the cash flow projections are heavily dependent on very high occupancy rates (95%-99%) which are often projected indefinitely into the future. While the market for this type of facility is currently underdeveloped in most areas, future market conditions may not offer the same potential. This reduced cash flow from a decreasing market may increase monthly fees to current residents, thus making the project even less attractive and secure for residents.

"b. The Entrance Fee

"As mentioned earlier, the entrance endowment required may range from less than $10,000 to over $70,000; however, the purpose and uses of these fees by the facilities varies tremendously across Ohio. Many facilities use the funds for capital building projects, and this is a relatively safe, interest-free way to develop or expand a capital program. Others use the funds for future operating expenses, and escrow the entire endowment, amortizing it over a specified period of time. Still others combine two purposes, using some of the fee for capital, and reserving the rest for future operating expenses. The funds may also be used to pay off project development and pre-opening management fees.

"Those funds used for immediate capital need only a minor reserve fund to protect against short-term cash flow problems (provided there is a monthly maintenance fee). Those funds used for future operating expenses should be escrowed and amortized over the expected period of use. In the latter case, when funds earmarked for future use are utilized for current operating expenses, the facility is courting a future financial disaster.

"In the case of the mixed purpose endowment, the developer (a profit-making corporation) receives all of its fees as soon as the facility opens. While the facility will carry a large mortgage, the organizer has been fully paid. Thus, the organizer has no financial incentive after the project is complete.

"c. Types of Facilities

"In the past, almost all life-care facilities were church related. Recently, however, there has been a growth of private, non-profit corporations which sponsor continuing care facilities. While the individual facility is clearly non-profit, the corporation that organizes and develops the project is often, a for-profit organization. In some cases, the developer may be just

one subsidiary of a for-profit holding corporation which not only develops the facility, but works with other subsidiaries that construct and design the project. While these private non-profit corporations assert their charitable nature, it is clear that they are in fact a profit-seeking business. While this may give them a more professional management staff, their motives may be subject to question. The profit-making goals of the developer may conflict with the financial stability of the non-profit corporation, e.g., in order to attract consumers and quickly raise funds, the pricing structure may be established too low to provide both profits and future financial stability. . . ."

Iowa: Violations Of Residents Rights

The Iowa State Department of Health has encountered a special kind of problem. Dana Petrowsky, Chief, Division of Health Facilities, Iowa State Department of Health in her May 2, 1983 letter to David Holton, Chief Investigator for the Special Committee on Aging provided details.

"The conflict we run into in regard to life care contracts, involves the right to not be involuntarily discharged, except for medical reasons, welfare of the resident or other residents, or non-payment of stay. Life care contract facilities in Iowa like to keep their beds full. Sometimes this means admitting 'non-member' residents to the health center. Then, when a member (life care contract person) needs the health center bed, the facility involuntarily discharges the non-member. This is in conflict to the Resident's Bill of Rights. This has resulted in the life care contract facilities having to maintain a certain number of beds open so they are available to the life care contract residents as needed."

Pennsylvania: The Million Dollar Minister

In late February of 1981, the Philadelphia Inquirer began a series of articles which detailed the complaints and suit by a small Pennsylvania church congregation against its one-time revered leader the Reverand Richard S. Coons. In their suit the church fathers alledged that Coons, their pastor -- a man who had been earning only $11,000 per year as a preacher -- used a loophole in Pennsylvania law for non-profit corporations self-dealing and the good faith and reputation of the church to build Open Door Estates Inc., a personal million dollar life care empire and to draw an annual income that top six figures. The Inquirer article of Sunday, February 22, 1981 lead with the headline: "From minister to manager of millions the non-profit way".

The following are excerpts from the series:

- "After formation of the first profit-making partnership, the life-care empire grew with dazzling speed.

"Work began on Open Door Estates North in 1975 and the project was finished about a year later. Almost immediately, Coons began forming another for-profit-partnership, this one to build a second Open Door Estates facility in Spring House. Construction of that complex began in 1977.

"Other profit-making partnerships were formed to finance and benefit from the construction of retirement communities which were begun in Boca Raton, Fla., in 1977; Southampton. Bucks County, in 1978 and Lima, Delaware County, in 1978. A second development was begun in Boca Raton in 1979 and is still under construction.

- "Mr. Coons and his associates -- many of them church members -- formed a number of profit-making firms which derived income by doing business with Open Door Estates.

- "As chief executive of Open Door Estates and a principal in the profit-making firms with which it did business, Mr. Coons was in a position to collect a salary from the nonprofit corporation and a share of substantial fees paid by Open Door. One such fee amounted to $1.2 million, court records show.

- "Mr. Coons' apparently conflicting interests were not revealed in documents filed with the Internal Revenue Service in four different years. The documents, which must be filed by tax-exempt organizations, require disclosure of potential conflicting interests.

- "On occasion, Mr. Coons and his associates portrayed Open Door Estates as owned and controlled by the Church of the Open Door. That was the representation when a zoning variance was sought and again in literature advertising the sale of units in the retirement communities.

"Under other circumstances -- such as those when church members demanded financial documents from the corporation -- Mr. Coons portrayed the corporation as the creation of a group of private investors with no connection to the church.

- "Although the initial retirement complex was conceived to serve elderly church members and retired missionaries, and is located directly behind the Fort Washington church, only 19 of the about 120 residents are church members.

- "More than 2,800 tenants now reside in facilities operated by the nonprofit corporation, which officially changed its name from Open Door Estates to Adult Communities Total Services Inc. last year.

o "There were several ways in which the partnerships profited from Open Door Estates. One was through lease-back deals.

"For example, the partnership purchased land in Spring House, constructed buildings and then leased the property to Open Door Estates, which operated it as Open Door Estates of Spring House. The monthly rent paid by the nonprofit corporation created a substantial cash flow for the profit-making partnership, which could use depreciation on the property to minimize the tax bite on that income. This was acknowledged by attorney Pepper, in a letter to The Inquirer."

". . . The prospective construction lenders to the retirement facility then under consideration required personal guarantees of individuals as collateral for their construction loan," Pepper wrote in the letter dated Feb. 5.

o "In view of this requirement concerning personal guarantees, and in view of the fact that there was a realization, at the time, that tax losses arising from depreciation of the facility to be cconstructed could not be utilized by the nonprofit corporation, but could be utilized by a partnership, the ODE partnership was formed," Pepper wrote. . . .

o "Leasing deals were not the only means through which cash flowed from the nonprofit corporation to Mr. Coons and his business partners. . . .

o "In all, Mr. Coons formed five profit-making partnerships, and several corporations which benefited from business deals with the nonprofit corporation operating the retirement projects.

"One was a management firm called Total Care Systems Inc. Court documents indicated that Mr. Coons owned 60 percent of the firm and Ted Bryant owned 40 percent. Mr. Coons was president of both Total Care and Open Door Estates; Bryant was vice president of both corporations, according to Bryant's testimony in the court suit brought by the church.

"Total Care routinely took a 5 percent cut of the total construction cost of a project.

"In 1980, Total Care Systems collected $414,111 in management fees from six complexes, according to a 1980 financial statement distributed to prospective residents of the Boca Raton facility. The statement also indicated that -- as of June 30, 1980 -- the complexes still owned Total Care additional fees amounting to $780,000.

"Mr. Coons and his business partners also billed Open Door Estates a $1.2 million 'development fee' for the Boca Raton projects, according to Bryant's testimony.

"Mr. Coons personally collected a $110,000 'executive management' fee in 1978 from Arol Fesmire, who built all of the projects. Mr. Coons listed it as a 'consulting fee' on his 1978 tax return.

o "'You'd have to look long and hard for a reason why a contractor would need a minister for a consultant,' said a former partner, who asked to not be identified.

"Money was shifted between the for-profit partnerships and the nonprofit corporation to save the partners thousands of dollars in taxes.

"But the fact that principals in the nonprofit corporation were involved in for-profit firms with which it had business dealings was not revealed in IRS forms filed by Open Door Estates.

o "Rev. Daniel Bartkow, public relations director for Open Door Estates Inc., called the lawsuit 'baseless.'

"'The allegation of improprieties contained in the complaint are absolutely untrue,' he said. 'For example, no funds of Open Door Estates Inc. have been misappropriated or improperly paid.'

"Mr. Bartkow said the complaint was 'irresponsible' and disregards the facts.

"'We are shocked,' he said, 'that this slanderous action filed by a church and sworn by a minister demonstrates such a deplorable lack of concern for the welfare of the residents in the retirement facilities of Open Door Estates.'

The suit initiated by the church fathers which alledged that ODE was really their corporation not Coons' was decided against them and in favor of Coons. He had, apparently, effectively established the corporation in a fashion that prevented any control by the church that had placed its trust in him. A court approved press release explained:

o "The court determined that ODE Inc. is a nonprofit corporation, totally separate from and independent of the Church of the Open Door. The court found further that the Church of the Open Door was not at any time a member, shareholder (or) owner of ODE Inc., and that the church had no other legal basis upon which to interfere with or challenge the ODE Inc. affairs."

The full text of selected articles are retained in Committee files.

Dr. Kenneth P. Berg: FTC Charges Unfair and Deceptive Practices:

Today, Dr. Kenneth P. Berg, one of the founders of the life care movement stands accused by federal and state authorities of extensive fraud and misrepresentation. Dr. Berg has published numerous books and articles on the subject of life care. He has been one of the most effective leaders in contributing to the growth of the life care industry. By himself, and in conjunction with Christian Service International (CSI), for which he is the chief executive officer, director and sole stockholder, he has been involved in one capacity or another with some 200 life care homes located in 25 states. Berg, though a reverend without a church, sees himself as a religious man whose calling is the financial promotion and development of life care facilities.

The Federal Trade Commission has just completed a two year, non-public investigation of Dr. Berg. In their bill of complaint they have charged him with unfair and deceptive practices, and failure to make disclosures of material fact to life care consumers.

In particular, the complaint charges that Dr. Berg and CSI have represented directly and indirectly:

- o "To purchasers and prospective purchasers of life care contracts that the life care homes marketed by them may be affiliated with some religious organization and that such organization may be legally and/or morally responsible for the debts and obligations of the providers of such life care homes. (While) in truth and in fact, no life care home marketed by respondents has any affiliation with any religious denomination or congregation or other religious organization which entails a legal or moral responsibility for the debts and obligations of the providers of such life care homes.

- o "That there is little or no financial risk involved in entering into the life care contracts offered by them. (While) In truth and in fact, in a significant number of instances, the life care contracts which respondents are offering to prospective residents may involve significant financial risk.

- o "That large institutional lenders which hold mortgages on the life care homes marketed by respondents would ensure their financial stability and economic survival. (While) in truth and in fact, the lenders holding mortgages on life care homes marketed by respondents have no legal obligation to ensure the economic survival of the life care homes covered by their mortgages.

- o "That increases in the service fees at the life care homes marketed by respondents, if necessary at all, would in no instance exceed corresponding increases in average Social Security benefits over the same periods of time. (While) in truth and in fact, in many instances life care homes marketed by respondents have raised monthly service fees in amounts

exceeding corresponding increases in average Social Security benefits over the same periods of time.

- o "That providers of many of the life care homes marketed by respondents have established sizable reserve funds, and that these reserve funds exist to ensure the financial protection of residents' interests in their life care contracts. (While) in truth and in fact, reserve funds established at life care homes marketed by respondents commonly exist primarily for the protection of the mortgagees' investments, and not for the protection of the residents' interests, and may be later waived by the mortgagees.

- o "Have misrepresented the financial positions and net worths of the providers of life care homes marketed by them by utilizing an accounting method which in the circumstances failed to match appropriately revenues to expenses, and which resulted in the overstatement of the financial positions and the net worth of many of the providers of such life care homes."

The complaint also charges that Dr. Berg and CSI have:

- o "Have offered and are offering for sale life care contracts without disclosing to prospective purchasers that architectural, construction supervisory and various other services at life care homes managed and/or marketed by respondents are commonly provided by various operating divisions and affiliates of the corporate respondent; that independent contractors commonly do not have the opportunity to competitively bid to provide such services; and that through the provision of such services the corporate respondent realizes various separate and substantial fees from the providers of such life care homes. Therefore, respondents have failed to disclose material facts relating to their sale of life care contracts which, if known to certain prospective purchasers, would likely affect their consideration whether to purchase such a life care contract.

- o "Offered and are offering for sale life care contracts without disclosing to prospective purchasers material facts with respect to: 1) pending litigation against respondents and/or the providers of the life care homes marketed by respondents, which, if adversely determined, might materially affect the ability of respondents or such providers to fulfill their obligations under the life care contracts; 2) a currently effective administrative order relating to respondents' marketing practices. Such material facts, if disclosed, would likely affect the decisions of certain prospective purchasers as to whether to purchase such a life care contract.

- o "Offered and are offering to prospective residents of life care homes marketed by them the option of paying all or a portion of their entrance fees in advance as a refundable deposit to ensure future residency in such life care homes without disclosing that

in many instances the payments are not escrowed or set aside in separate accounts for such future residents. Therefore, respondents have failed to disclose material facts relating to their treatment of prepaid entrance fees which, if known to certain prospective residents, would likely affect their consideration whether to prepay their entrance fees or purchase a life care contract.

- o "Have offered and are offering for sale life care contracts without disclosing to prospective purchasers that certain of the moneys derived from entrance fees and service fees are sometimes used in connection with transactions involving entities not directly related to the specific life care homes in which the prospective purchasers may reside. Therefore, respondents have failed to disclose material facts relating to the uses of the moneys to be paid by prospective purchasers, which if known to certain of them, would likely affect their consideration whether to purchase such a life care contract."

In concluding their complaint the FTC stated:

- o "The use by respondents of the aforementioned unfair and deceptive acts or practices has had the capacity and tendency to mislead and deceive the purchasing public.

- o "The aforementioned acts or practices, as herein alleged, were and are all to the prejudice and injury of the public and respondents' competitors and constituted and now constitute unfair methods of competition in or affecting commerce and unfair and deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended."

Dr. Berg signed a consent agreement with the Commission in which although not constituting an admission that he violated the law, he agrees to immediately cease and desist from the same practices alleged in the complaint document.

Dr. Berg: States Charge Fraud:

In at least Alabama, Iowa and Missouri, suits have been filed against Dr. Berg and CSI. Most allege violations of various fraud and consumer protection statutes. So extensive is becoming the litigation against Berg that a special conference of state prosecutors, U.S. Postal Inspectors and Federal Bureau of Investigation agents was convened to confer on investigative and prosecution strategies. Alabama alone charged Berg with 150 counts of securities fraud. Curiously, one of Berg's operations in Alabama had been taken over by him from an earlier operator, Reverend James Ballard, who himself had been indicted and jailed one year earlier, also for life care fraud.

Commissioner Patricia Bailey who guided the FTC decision on this case; Mr. Patrick Robinson the assistant Attorney General for Alabama who brought the charges against Berg; and Mrs. Helen Bishop a resident who lost her life savings to the Ballard/Berg failures in Alabama will all present testimony at the committee's hearing.

LAWS AND REGULATIONS

Federal Legislation:

Currently, there is no specific federal regulation of the life care industry.

95th Congress:

Mr. Cohen introduced H.R. 807 the "Continuing Care Consumer Protection Act" as well as several refined versions of the same measure (H.R. 3232 and H.R. 4170) during the 1st session of the 95th Congress. In its final form the bill defined as a "federally assisted continuing care institution" any institution, organization or other person which is engaged in nursing or other long-term care of elderly individuals and others, and which is engaged in interstate commerce and was constructed or operated with full or partial use of federal funds (including medicare and/or medicaid). The bill went on to specify that continuing care contracts offered by these facilities must give full written disclosure of a number of items such as financial conditions, services offered and the lack of property rights associated with payment of fees. The Secretary of HEW was to be given authority to enforce these disclosures. A private right of action was included for those whose rights under the provision had been violated. Referred jointly to Ways and Means and Interstate and Foreign Commerce the measures were not reported from Committee.

96th Congress:

Mr. Dicks and Mr. Magnuson introduced respectively, H.R. 13732 and S. 3538, companion measures which sought to amend the Internal Revenue Code with respect to the period for including in gross income certain advance payments accrued by life care communities. In essence, the bills were designed to allow life care communities that used an accrural accounting system to spread their income from entrance fees across a ten-year base thereby reducing their current year tax obligation. The bills were referred to the Ways and Means and Finance committees respectively and neither was reported out.

97th Congress

Mr. Dicks reintroduced H.R. 13732 from the previous Congress. No action was taken on the bill.

STATE LAWS AND REGULATIONS

Being a relatively new and growing phenomenon life care is just beginning to be understood and regulated. Sometimes the level of understanding is not adequate to the job at hand. California in 1969 was the first State to regulate life care. Even with regulations, probably the nations most notable life care failure occurred when, in 1979, Pacific Homes, a California based, Methodist related organization declared bankruptcy.

Eleven states regulate the operation of life care communities. These states are: Arizona, California, Colorado, Florida, Illinois, Indiana, Maryland, Michigan, Minnesota, Missouri and Oregon. New York, which bans pre-paid nursing home care; effectively prohibits life care arrangements. There is little uniformity in the way these facilities are regulated by the states. Arizona for example places regulatory responsibility for life care homes with the state Department of Insurance, California uses a Life Care Contract Advisory Board under the Department of Social Services, Illinois lodges responsibility with the Department of Health, while Indiana looks to its Securities Commissioner for direction about life care.

Industry representatives have not always been supportive of stiff regulation. In an April 21, 1980 memorandum to AAHA state executives, Katrinka A. Smith, a Policy Research Analyst wrote:

> ". . . there are a number of states that are exploring possible courses of action with regard to continuing care. The Ohio Nursing Home Commission has debated the issue, but no legislation has ever been introduced in the Ohio General Assembly. AOPHA has played a role in the Commission's discussions by preparing a position paper on life care contracts, in which they express their strong opposition to any legislation which would control either the language of continuing care contracts or particular operations of continuing care homes. . . .Regulations have frequently resulted in a massive administrative network, rather than resulting in a set of reasonable terms under which a provider can easily operate. In other words, regulations can, in some situations, overly infringe upon the management of a facility. . . ."

The memo went on to quote a statement from the Ohio based AOPHA which stated:

> "The types of Life Care Contracts and payment arrangements thereunder are so varied and complex and of an individual nature, that to attempt to legislate a control over them would be nearly impossible without imposing considerable injustices that would far outweigh any benefits attempted."

Ohio has no life care law.

Some states require operators to make public ownership and financial disclosures, others do not. Similarly, some states regulate Resident Rights and others do not. Few if any of the states offer adequate protection from the operator who deliberately seeks to use complex profit/non-profit business structures and non arms length transactions to enhance his personal wealth at the expense of the life care residents.

In those states where no regulations specific to the life care industry exist, courts have tended to hold that the life care agreement entered into between the resident and the facility is a contract entered into by two otherwise responsible parties. And in the absence of outright fraud, if a resident signs a contract which does not provide for the protection of his/her rights and property in the event of a bankruptcy, the principal of Caveat emptor prevails, and the right of reparation is lost.

Law Review Article:

Probably the most comprehensive and thoughtful analysis on the need for regulation in the life care field has been written by David Cohen and published in the Pennsylvania Law Review in April of 1980. His article was written "In response to a number of intrinsic failings and weaknesses in the (life care) institution and the current regulatory vacuum."

Cohen urges that we avoid the trap of treating regulations as a panacea. He argues that initial resolution of the continuing care problem is a scheme

> ". . . of nonintrusive governmental regulation designed (1) to provide minimum economic safeguards for residents and (2) to enhance the functioning of normal market mechanisms through consumer education. The basic financial protection . . .(would be) provided through the proposed reserve and escrow requirements, minimum regulation of financing methods, and mandatory mutual guaranty associations. Consumer education . . . (would be) achieved through proposals for advertising regulation, contract-term regulation, and full disclosure of community finances and practices. Finally, a study commission required to report on the effect of these proposals. . . (would) serve as a bridge between this first-level regulation and a second, possibly more intrusive phase.
>
> "In the event the first-level regulation fails to stabilize the continuing-care industry, more burdensome devices, such as certification requirements and authorization of the use of investigative and injunctive powers, are proposed. Should even these measures prove insufficient, the third-level direct fee regulation could be imposed.

"The proposals set forth in this Comment are realistic responses to what are considered manageable problems of an institution of great importance to our nation's elderly people. Their goal is to guarantee that continuing-care communities can offer care that is truly continuing. . . ."

Mr. Cohen will testify at the Committee's hearing.

A Committee requested Library of Congress review of state life care statutes is available at the committee office for review.

The Hearing

These and other similar letters of complaint, the recent completion of a major national research project which provides the first reliable data about the industry, and the recent completion of the Federal Trade Commission of a two year, non-public investigation of one of the largest life care providers have combined to spawn the Committee's hearing on life care.

Appendix 1

PRELIMINARY AND CONFIDENTIAL

CONTINUING CARE RETIREMENT COMMUNITIES: AN EMPIRICAL, FINANCIAL, AND LEGAL ANALYSIS

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CHAPTER 14

SUMMARY AND CONCLUSIONS

This chapter contains an overview of the research presented in the preceding twelve chapters and summarizes the authors' recommendations in three subject areas. In addition, several areas for further research are listed. The three areas covered in this book are: (1) an empirical survey of CCRCs that describes the various characteristics of existing communities; (2) a financial analysis of CCRCs which includes current financial management practices along with an extensive analysis of how actuarial science can be applied to developing appropriate fees and insuring the long-term financial health of CCRCs; and (3) a legal analysis that first describes the current status of CCRC regulation among the various states and then sets forth those areas where the authors believe that regulation is and is not appropriate.

The following summary cannot possibly serve as an adequate substitute for a thorough reading of each chapter. In many instances, especially in the financial and legal areas, there is no clear cut answer to the many issues raised and discussed, requiring that the management of CCRCs exercise judgment as to the approach that should be taken for their community. The conclusions and recommendations provided below represent, in those areas where judgment is required, the authors' best judgment. The chapters themselves, however, set forth the various points of view so that conscientious readers will be in an excellent position to form their own conclusions.

EMPIRICAL SURVEY

Size of Industry

The study was able to identify 274 communities throughout the United States that met the following definition of a CCRC.

- o The facility consists of independent living units and generally has one or more of the following facilities: (1) congregate living, (2) personal care, (3) intermediate nursing care, and/or (4) skilled nursing care;
- o The community guarantees shelter and various health care services to residents under a contract that lasts for more than one year;
- o The additional fees for resident health care, if any, are less than the full cost of such services, implying a risk pooling of health care costs among residents.

The study also identified another 120 communities that offered services similar to CCRCs but did not precisely meet the characteristics listed above. For example, a number of communities that would have been classified as CCRCs in prior years have changed their contract so that residents now pay the full cost of any required health care services. These communities are not considered CCRCs as defined by this study.

The survey conducted as a part of this study collected an extensive amount of information on 207 of the 274 identified CCRCs. This represents a response rate of 76%, implying that the characteristics summarized here and discussed in detail in Chapters 2 and 3 are quite accurate for the industry as a whole. While it is true that the 24% not responding may have a systematic characteristic (for example, they may consist of predominantly financially distressed communities that did not wish to be examined), the authors believe little or no such systematic bias exists in the sample.*

The 207 communities identified in the study currently serve 55,000 individuals all over age 65 and whose ages range predominantly from 75 to 85, the average age being about 81. This is a relatively small fraction of the total number of individuals over 65 in the United States (0.2%) and the number of individuals expected to fall within this age range during the next several decades. Therefore, the authors believe there is a tremendous potential for increasing the number of CCRCs to serve aged Americans.

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*One fact leading to this conclusion is that the communities participating only after extensive follow up efforts showed no characteristics distinctively different from those that participated after the initial contact.

Moreover, as discussed later in this summary, it appears that the cost of entering and living in a CCRC appears to be well within the reach of a large number of such individuals.

About 20% of all CCRCS were formed prior to 1960, 40% were built between 1960 and 1970, and the remaining 40% were constructed since 1970. The median age of all communities is 14 years; however, there are numerous communities constructed prior to 1960 that have offered continuing care contracts for decades.

Physical Aspects of Communities

The survey results indicated quite a range in the physical characteristics of CCRC facilities. Half of the communities have only a skilled nursing facility in conjunction with their independent living units, while the other half also have a personal care facility. The authors believe that the latter type of configuration, providing a continuum of health care services, is probably the most desirable approach in terms of the quality, appropriateness, and economic efficiency of delivering health care services to CCRC residents.

The number of independent living units per community is uniformly distributed from 50 to 300 units; however, there exists a distinct trend toward a larger number of units in newer communities. The authors believe it is desirable, from an economic viewpoint, to build CCRCs with at lest 250 independent living units. This size provides economies of scale in management and allows the construction of a skilled nursing facility that meets the needs of the population on the one hand while complying with state regulations on the other.

CCRCs are evenly split between garden apartment, or low rise, structures and high rise structures. The main determinant of the type of structure is the suburban versus urban location of the facility. None of the analyses suggested that one type is perferrable over the other.

The geographical distribution of CCRCs throughout the United States follows the distribution of aged individuals with one important exception. The exception is the state of New York where CCRCs as defined in this study are not permitted under law. Based on the research findings contained in this book that CCRCs are not only financially viable but are within the financial reach of a large number of aged individuals, the authors believe strongly that the laws in New York should be changed to accommodate CCRCs. Over two thirds of the CCRCs are located in the following states, listed in order of the number of communities per state: California, Florida, Pennsylvania, Ohio, and Illinois.

Fee Levels. The average entry fee for CCRCs as of December 1981 was $35,000, with an additional $2,000 being added for the second of two individuals sharing an apartment. The average entry fee per square foot of independent living unit is $60. The range in entry fees is fairly wide, with 80% of all communities having entry fees falling in the range of $13,000 to $65,000.

The average monthly fee among CCRCs as of December 1981 was $550, with 80% of such fees falling in the range of $300 to $900 per month. The increase in monthly fees for a second person living in an apartment unit was found to be $250, an increment much greater, percentagewise, than the corresponding increment in entry fees.

Although a convincing actuarial argument can be made that entry fees and monthly fees should vary by such factors as the resident's entry age, sex, and health status, CCRCs tend to vary fees by the apartment type selected by the resident and whether a second person is involved. This implies that the management of such communities are not only socializing health care expenses but are also socializing the costs associated with other factors that affect the cost of providing future shelter and health care throughout the lifetimes of residents.

The fee ranges charged by CCRCs appear to be within the financial grasp of the majority of individuals over age 70. This is an important finding, since it suggests that CCRCs are not exclusively for the wealthy aged individuals in the United States.

Interestingly, 75% of CCRCs provide financial aid to those residents whose financial resources become depleted. Although most CCRCs reserve the right to terminate the contract of individuals who lack the financial resources to pay their monthly service fee, the survey did not find one instance where this has occurred. This reinforces the point that CCRCs are affordable by a large number of aged individuals in the United States. Even in those cases where an individual's longevity coupled with inflation-related increases in monthly fees causes financial difficulties, such institutions are able to continue the care that the individual expected upon entering the community through financial assistance.

CCRCs are evenly split on the issue of offering partial entry fee refunds at the death of the resident. With respect to the half that provide such refunds, the methods used in determining the dollar amount vary significantly, there being no common approach found among the communities.

Services Provided. CCRCs are evenly divided between those that offer an extensive health care guarantee and those that offer a limited guarantee. The differences between the two are as follows:

- **Extensive Guarantee:** Residents pay the same monthly service fee while in the health care center as they paid while living in their apartment unit (or, if the monthly fee differs, the health care monthly fee is less than 80% of the per diem rate for such services).

- **Limited Guarantee:** Residents pay the per diem rate while in the health care center; however, such higher fees do not begin until after a specified period of health care center residency, such as 180 days.

Thus, contrary to the belief that, once an individual enters a CCRC, health care services are a free good, the the basic insurance principle of "co-pay" is widely used among CCRCs. Surprisingly, however, the data indicated less health care utilization among

residents in CCRCs with extensive health care guarantees. Perhaps this can be explained by the fact that the management of such CCRCs has a greater financial incentive to monitor and manage health care utilization. This is an area deserving of additional research, since the results are at odds with the general believe that the lower the cost of health care the more such services will be used.

With respect to the number of meals offered under continuing care contracts, again communities were found to be evenly split between those offering three meals per day as a part of the basic fee structure and those offering one meal with residents paying additionally if more than one meal per day is prepared for them by the community. However, there is a trend among newer communities to include only one meal, thus giving residents more freedom in structuring services to best meet their needs.

Affiliation and Management. Virtually all CCRCs are non-profit organizations with religious affiliations. One-third of the communities purchase management services from an outside organization, generally a for-profit organization, while the remaining two-thirds are self managed.

FINANCIAL ANALYSIS

The financial analysis of CCRCs comprises eight chapters in this book, Chapters 4 through 11. Chapter 4 provides an overview of the subject matter; Chapter 5 discusses the types of actuarial assumptions required to perform appropriate financial analyses of CCRCs; Chapter 6 describes how the future resident population of a CCRC can be projected with confidence, a process that represents the first step in financially analyzing the future of a CCRC; Chapter 7 discusses the actuarial theory for establishing appropriate fees for new entrants to a community; Chapter 8 provides a methodology to assist management in selecting the appropriate annual fee increases that are required to maintain the long-term financial soundness of the community; Chapter 9 illustrates the cash flow of a CCRC over a twenty year period and shows why conventional accounting procedures are not adequate for financially monitoring such communities; Chapter 10

gives an overview of the fundamentals with respect to financial statements in general and as they are typically applied to CCRCs; and Chapter 11 discusses the modifications that need to be made to traditional accounting statements so that the management of such communities has the proper information for maintaining their long-term financial success. An overview of the findings and recommendations presented in these eight chapters is given below.

Actuarial Assumptions. There are several types of actuarial assumptions required in performing financial analyses of CCRCs, two of the more important ones being mortality rates and morbidity rates. One of the recommendations of the study is that the CCRC industry must begin to develop a national data base for use in developing community specific rates. Although it is true that the mortality and morbidity experience varies among communities, a national data base would provide the basis for monitoring each community's experience and would also provide valuable information to those individuals who are planning a new facility.*

As a part of this study, the mortality and morbidity experience of seven communities was studied. This data base, which consists of 25,000 life years (where one life year represents an individual living in a community for one year), indicats that the life expectancy of CCRC residents is significantly longer than the life expectancy of individuals the same age in the general population. In fact, the life expectancy of CCRC residents is comparable to the life expectancy of individuals who purchase annuities from insurance companies. Overall, the life expectancy of both groups is about 20% greater than the general population. The greater life expectancy of CCRC residents could, in fact, be due to the same reason that annuitants' life expectancy is greater; namely, such individuals tend to be in good health at the start of the contract. However, some

*The insurance industry has pooled the experience of large companies in developing mortality rate for many years. The authors are suggesting that this same degree of cooperation would be beneficial to the life care industry as well.

individuals believe that there may be additional factors associated with CCRC residents, such as ready access to good health care, the closeness to one's spouse if he or she is transferred to the health care center, the communal spirit among residents, the opportunity to remain quite active in various recreational activities, and so forth. Whether such factors make a difference in the life expectancy of CCRC residents must be studied in future research.

The data base also suggests that there may be potential savings assocaited with the lower hospital utilization of CCRC residents as compared to the general population. Although the data base was too thin to draw definitive conclusions, this finding could have important implications relating to the cost of delivering health care to older Americans, and the authors suggest that this is a rich subject for further research.

The final point with respect to actuarial assumptions is the manner in which such assumptions are being used by those performing financial analyses of CCRCs versus the way such assumptions should be used. One of the serious misapplications of actuarial assumptions is the use of life expectancies for determining when lump-sum entry fees are considered as income to the community. This subject will be mentioned again at a latter point in this summary.

A second serious mistake is that financial planners do not distinguish between mortality rates applicable while the individual is living in an apartment and the corresponding (and higher) mortality rates applicable while the individual is living in the health care center. While it is true that the overall mortality rates of CCRC residents follow those of an annuitant mortality table, the table itself is of little value in performing financial analyses. The annuitant mortality table must be decomposed into two tables, with lower rates applicable to apartment lives and higher rates applicable to health care center lives. The reason this split in rates is important is because the cost of caring for individuals differs significantly depending on their living status. Applying one table to all residents means that death rates for apartment dwellers will be too high

(implying that projected apartment turnover rates and hence projected entry fee income will be overstated) and death rates for health care center residents will be too low (implying that the projected cost of health care will be too high). This misapplication can cause serious errors in the financial analyses of CCRCs.

Population Projections

In order to perform a financial analysis of a CCRC, whether a new or existing community, it is necessary to project the resident population on a year by year basis for a period of years into the future, calculating each year the expected number of apartment releases, the number of individuals expected to be transferred to the health care center, and so forth. One of the significant deficiencies observed in the industry is that existing communities, by and large, do not engage in this type of projection and, moreover, the projection period associated with financial feasibility studies for developing communities is generally limited to five or seven years. The authors recommend that all communities engage in such forecasts periodically, and that such forecasts extend for a period of twenty years or more, especially for new communities where the expected health care utilization is expected to be lower during its maturation (the first ten to fifteen years of operation) than the ultimate expected utilization.

This research discusses and illustrates the problem of random deviations associated with projecting a population of only a few hundred individuals. Even if the underlying mortality and morbidity assumptions are precisely correct, a deterministic projection of the population will not reveal the likely variations in rates of death and morbidity, and their corresponding impact on the financial health of the community. Adding to this problem is the fact that the underlying rates themselves may be somewhat off the true rates. These two problems poses a significant barrier to adequate financial planning with respect to CCRCs. Therefore, two of the major conclusions of this research are that: (1) multiple projections must be made using various sets of pessimistic and optimistic rates in order to assess the implications of making an error in the

underlying assumptions (i.e., performing a sensitivity analysis), and (2) the projection must incorporate stochastic (or Monte Carlo) methodology. Under stochastic methodology, the population projection includes random deviations. Thus, an estimate is made of the best and worst that is likely to occur, enabling management to plan accordingly.

The population simulations presented in connection with the population projection analysis showed that it takes fifteen years or more for a new CCRC to reach maturity, where maturity is defined by such statistics as a relative stable year to year average age of residents, a relatively constant number of residents living in the health care center on a permanent basis, a relatively stable apartment turnover rate (ignoring random deviations), and so forth. Thus, long-term projections are critical to the proper financial planning and management of such communities.

The simulations revealed some interesting statistics, in addition to the data on the length of time it takes a new CCRC to reach a mature state. For example, the density ratio (i.e., the ratio of apartment residents to the number of apartment units) is likely to decrease to some ultimate level from the ratio at the time the community is first opened. The initial densitiy ratio, of course, is dependent on the number of couples in the start-up resident population. Similarly, the ultimate density ratio will be dependent on the number of couples assumed to enter in future years and the community's policy on the transfer of an individual to a smaller apartment unit upon the death or permanent transfer of his or her spouse. Depending on the pricing structure of the community, the density ratio can have an important financial impact.

The simulations also showed, for the set of assumptions used, that the expected period of time spent in the health care center for all entrants will average 3 to 4 years. Moreover, since only half of the entrants will ever reside permanently in the health care center, this statistic implies that the average length of stay for those that do transfer is 6 to 8 years. Given this tenure, and the high cost of caring for an individual in the health care center, it is essential that management take such data into account in developing

fees. The research found also that management policies and the community's health care delivery system (i.e., whether there is only a skilled nursing facility as opposed to a continuum of care possibly represented by a home nursing program, personal care facility, intermediate care facility, and a skilled nursing facility) both play a significant role in determining the community's health care costs. Those communities that strive to avoid transfers to the skilled nursing facility until it is absolutely necessary have lower health care costs but also have lower apartment release rates (and, hence, lower entry fee revenues), and vice versa. Since these factors are important, it is essential that the population methodology, along with the underlying actuarial assumptions, reflect both management policies and the community's health care program.

Finally, over the years a number of rules-of-thumb have been developed regarding such important items as apartment turnover rates, health care utilization, density ratios, and so forth. This research has found that these rules, at best, are not very good in performing financial analyses of CCRCs. There are too many differences among communities, such as management policies, health requirements at entry, health care programs, and so forth, for such rules to be relied upon when financially analyzing a community. Therefore, the authors strongly recommend against relying on such rules-of-thumb in establishing fees and/or projecting the population of a CCRC.

New Entrant Pricing

As noted earlier, Chapter 7 sets forth the actuarial theory for establishing fees for new entrants to a CCRC. As a precursor to developing fees, however, and undoubtedly a new concept to the CCRC industry, the authors introduce the concept of an actuarial liability for new entrants. This actuarial liability is equal to the present value of all future expected expenses on behalf of the individual throughout his or her lifetime in the community. For example, the actuarial liability for a female age-75 entrant, under the hypothetical community and set of assumptions used in the research, was calculated to be $150,000. Put another way, if this amount were paid by each such

individual at entry (a pricing policy **not** being recommended by the authors), then this amount along with interest earnings on the unused balance would be sufficient to pay all of the expected expenses for the individual (provided that all of the assumptions are realized).

The actuarial liability for an individual is dependent on three sets of factors: (1) **demographic factors**, such as the entrant's age, sex, and health status, (2) **contractual factors**, such as the community's death refund provision, the extensiveness of its health care guarantee, and so forth, and (3) **accounting factors**, such as the manner in which the cost of fixed assets (i.e., building and furniture) is allocated over time, the allocation of operating expenses (i.e., on a per capita versus a square footage basis), and (4) **economic factors**, such as future inflation and interest rates. Although many of these factors are technical, the point is that each individual entering the community has an associated actuarial liability depending on a large number of factors, and it is this liability which is the basis for determining fees.

Once the actuarial liability has been determined for an individual, or group of individuals, the next step is to decide what portion of the liability is to be paid by entry fees and what portion is to be paid by monthly fees. Theoretically, the mix between the two can range from 100% entry fees to 100% monthly fees; however, neither extreme is recommended by the authors. For reasons detailed in Chapter 7, the authors believe that entry fees should not exceed 30 to 40 percent of the actuarial liability.

Another approach to determining the entry fee/monthly fee mix is to assume that entry fees cover capital costs while monthly fees cover all other costs. This generally results in an entry fee that does not exceed 40% of the actuarial liability and, supposedly, such an approach has appeal to prospective residents. There is nothing magic or correct about this approach (sometimes called the real estate/actuarial approach to setting fees), since it is simply one of an infinite number of ways to split the actuarial liability between entry fees and monthly fees.

Assuming that the actuarial liability and the mix between entry fees and monthly fees has been determined, it is still necessary for management to decide whether fees will reflect all of the factors that affect the actuarial liability itself. In other words, since the actuarial liability is higher for females and higher for younger entrants, for example, should fees also be higher for these individuals? Similarly, since the actuarial liability differs by type of apartment and by the number of individuals entering the apartment (i.e., single versus couple), should fees differ by these factors as well? These are areas where management must decide what dimensions the fee structure should reflect. Most CCRCs have fees that differ by apartment type and whether there are one or two individuals occupying an apartment. This type of a pricing structure, therefore, socializes the cost of numerous dimensions, a management policy that is perfectly acceptable provided that the overall fee structure is equal to or greater than the overall new entrants' actuarial liability. The authors have no recommendation regarding the distribution of costs among residents as long as the actuarial test is achieved.

Finally, with respect to the development of fees for new entrants, the authors set forth two objectives that appear to be reasonable and desirable for CCRCs:

- **Group Equity:** Fees for a group of entrants should be self-supporting, implying that the fees associated with future groups should not be required to pay for the services used by prior groups;
- **Inflation-Constrained Increases in Monthly Fees:** The annual increases in monthly fees should not exceed the community's internal inflation exposure, implying that the increased cost of greater health care utilization during the community's maturation period must be advance funded.

The authors recognize that these are objectives that may not be shared by all CCRC managements, in which case the pricing structure of their communities could differ significantly from the structure that logically follows from such objectives.

Actuarial Valuations

An actuarial valuation involves the application of actuarial science for determining if a community's aggregate assets (current assets plus prospective fees) are equal to its aggregate liabilities (current liabilities plus prospective costs for all residents). If such an equality exists, then the current fee structure is adequate, whereas if the asset-liability relationship is not equal then fees should be changed to bring about the balance. One of the most important recommendations of this research is that CCRCs, and especially new CCRCs, should have an actuarial valuation performed periodically, such as annually or every two or three years. In addition to determining if the community's assets are in balance with its liabilities, an actuarial valuation provides information on how fees should be adjusted from year to year to achieve and maintain such a balance. In other words, even if a community is in actuarial balance currently, random deviations during the following year will inevitably cause the balance to be altered. An actuarial valuation provides management with the financial implications of such deviations as well as guidance on the fee changes that should be made to restore the balance.

An actuarial valuation does not, however, provide management with information on the proper level of liquid assets, or working capital, to be maintained. However, this research clearly demonstrates that a community that has an actuarially based fee structure will inevitably generate far more liquid assets than the minimums that various accounting techniques (or cash management techniques) would suggest. The fact that an actuarially fee-based community will generate significant amounts of cash, all of which is required to meet the long-term health care liability and other future commitments of the community, reinforces the need for actuarial valuations. This is the case, because the management of non-profit organizations are often reluctant to allow such funds to build up and/or residents object to fee increases when sizeable amounts of funds are on hand. An actuarial valuation not only determines the total amount of assets that a community must have but allocates such assets to various liabilities, such as the health

care liability, thereby showing to management and residents that such funds are not redundant and that fees should continue to increase with the community's inflation experience.

If an actuarial valuation of a community shows an unfunded actuarial liability (i.e., aggregate assets are less than aggregate liabilities), management has several options for funding it, such as a one-time percentage increase in fees over and above the current year's inflation increase, a temporary percentage increase over and above inflation for a period of years, a flat dollar surcharge on fees for a period of time, and so forth. The only requirement is that the additional increase in fees pays off the unfunded liability either in the current year or over a period of years. The authors recommend that such unfunded liabilities be funded over as short a period as possible, subject to marketing constraints and the ability of residents to pay the increased fees.

With respect to year to year random deviations, two methods for dealing with the corresponding change in the unfunded liability are discussed. One method is to adjust fees each year to fully account for the deviation. The other method is to build up a buffer fund, or contingency fund, against which unfavorable deviations are charged and favorable deviations are credited. Under this approach the size of the fund can be evaluated periodically and adjusted to the proper level if it has grown too small or large. Either approach is acceptable from the authors' viewpoint.

Case Study Results

All of the actuarial techniques developed in the study were applied to six CCRC case studies. The communities selected to participate in this portion of the study were not selected on a random basis; therefore, it is not possible to generalize from the results. Nevertheless, it was interesting to discover that the fees charged for five of the six communities placed them in reasonable actuarial balance. The fees for these communities fell in the following ranges:

- Weighted Average Entry Fee Range: $25,000 to $55,000
- Weighted Average Monthly Fee Range: $400 to $800

Given the fact that these fee ranges produce reasonable actuarial balances, it appears that CCRCs are well within the financial grasp of a large number of Americans over age 65 and that the CCRC concept is a financially viable one.

One of the communities studied was found to be in severe financial distress; however, it was later learned that improper management practices contributed to this situation. Therefore, it was not possible to tell whether its current pricing structure would have supported the continuation of the community if such circumstances had not occurred.

Financial Management Statements

As noted previously, the cash flow of an actuarially priced community will generally be quite strong. The problems associated with a CCRC accumulating significant amounts of cash were also mentioned. Moreover, accounting statements that are prepared according to generally acceptable accounting practices (GAAP) were found to contribute to this problem because they do not reflect the future long-term liability of the community. Generally speaking, the authors found three areas where GAAP statements could be modified to better represent the financial picture of a CCRC:

- **Entry Fee Earnings:** The current practice is to earn entry fees over the life expectancy of an individual, or group of individuals. This approach was found to bring too much money into the community's income statement too fast. Therefore, the authors recommend that entry fees should be earned over an individual's lifetime on an increasing dollar basis, an approach that better matches revenues with expenses;

- **Expensing Fixed Assets:** Expensing fixed assets according to a cost based depreciation schedule charges too little for the asset in an inflationary environment. Therefore, the authors recommend that such statements should be based on a replacement-basis depreciation method.

- **Health Care Fund Accounting:** Most accounting statements co-mingle the apartment side of the CCRC with the health care center side. This adds confusion and often masks the true financial picture of the community. Therefore, the authors recommend that fund accounting be employed to generate separate statements, one for apartment cost center revenues and expenses, and one for health care cost center revenues and expenses.

LEGAL ANALYSIS

The legal analysis of CCRCs is presented in the final two chapters of this book. An overview of that material is given in the following subsections.

Current Regulation

The study contains a descriptive analysis of existing formal legal regulation of CCRCs. This material serves as a foundation for the study's analysis. For analytic purposes, the study divided its discussion of the current regulatory status of the continuing care industry in three parts:

- **Detailed State Regulatory Schemes:** The study first discusses the repsonses of nine states and at least one organization — detailed regulation of CCRCs. The issues covered in this analysis include the definition of communities to be regulated, government certification/private accreditation, regulation of financial status, protection of residents' rights, and the legal structure of the community.

- **Limited State Regulatory Schemes:** The study also discusses the responses of at least three states — selected regulation of one or two of the problems of the continuing care industry most susceptible to legal regulation.

- **Nonregulation:** The third division of the study discusses the responses of the remaining thirty-six states, the District of Columbia, and the federal government — virtually total nonregulation. Included in this discussion are comments on proposed, but as yet unenacted, legislation and judicial attitudes towards CCRCs.

Evaluation of Legislative Options

The core of the study's legal analysis of CCRCs is presented in Chapter 13. That chapter contains the study's conclusions, underlying analysis, and recommendations for future legislative action concerning the continuing care industry.

The full contours and rationale underlying all the judgments reached by the study in its legal analysis cannot be explained in general terms; rather, the conclusions can be justified only through analysis of the value judgments drawn with respect to each element of regulation. As a result, both chapters of the legal analysis are organized

according to the various elements of regulation identified by the study. Some of the highlights of the study's conclusions and recommendations are as follows:

- **Type of Legislation:** Foremost among the judgments drawn by the study is its conclusion that legislation at the state, rather than federal, level will be appropriate in many states. The most substantial justification underlying this judgment is the study's view that, because CCRCs are still relatively new, it would be advantageous to encourage the variety of legislative programs that would develop at the decentralized state level.

- **Certification:** The study concluded that certification requirements should be adopted by all states implementing continuing care legislation. This conclusion is tempered by the study's recommendation that each state approve private self-accreditation programs that meet certain specified standards and, once approved, perform the accreditation function for the state.

- **Escrow:** For existing communities, the study recommends that legislation require all entrance fees, including refundable deposits in excess of 5% of the then-existing entrance fee for the unit requested, to be held in a cash escrow account to be released to the community on the day that the unit becomes available for occupancy by the resident. For new communities, the study recommends that state legislation require all entrance fees and refundable deposits to be held in a cash escrow account until the CCRC becomes 50% subscribed, commitment has been secured for both construction and long-term financing, and aggregate entrance fees received by or pledged to the provider plus anticipated proceeds from financing equal not less than 100% of the aggregate cost of construction or purchasing, equipping, and furnishing the community plus not less than 100% of the funds necessary to fund start up losses of the community.

- **Reserve funds:** Although the study makes no specific recommendation at the present time on reserves, we feel strongly that mandating actuarially sound reserves is the best long-term legislative solution. At this point, however, more research is necessary on this issue.

- **Financial disclosure:** The study recommends that all states regulating the continuing care industry mandate financial disclosure to residents. The study's recommendation is for both a complete disclosure form to be filed with the state and a simplified disclosure form including a clear narrative description of the financial condition of the community to be supplied to all prospective and current residents.

- **Contract regulation:** The study has concluded that both the form and content of this continuing care contract should be regulated by the state. The state, however, should not regulate the precise wording of continuing care contracts; rather, the optimal statute should simply mandate the subject areas that each continuing care contract should cover.

- **Advertising regulation:** Although the study concedes that this is a close question, we have concluded that some form of advertising regulation is an essential component in any legislation of the continuing care industry. Misleading advertising, therefore, should be expressly forbidden. In addition, the study requires all advertising, promotional, and solicitation literature to be submitted to the administering agency for approval. Failure of the agency to respond within fourteen days should be statutorily deemed to be approval of the advertising.

- There is a need to develop and further test various methodologies for determining whether fees are set to maintain long-term financial viability; however, these mechanisms should avoid the disadvantages of trying to apply a simple mechanistic formula to all cases.

- Other topics include expanding and strengthening pre-construction requirements to protect bondholders' interests and establishing a formal disclosure criterion to minimize possible abuse through conflict of interest by management and Board members.

AREAS FOR FUTURE RESEARCH

During the two years of study leading to this book, it became clear that there were a number of issues related to continuing care which required additional research and evaluation.

Although these issues were outside the scope of the study, the authors and members of the Advisory Committee feel strongly that consideration should be given to these issues, which include the following:

- How large is the demand for continuing care and how widely can the continuing care concept be applied successfully?

- Do CCRCs help to prolong life and if so, what specific factors produce this longer life expectancy? Based solely on a review of life expectancies in this study, CCRC entrants seem to live longer than the general population.

- Contrary to the general belief that more health care services are used when the cost is lower, the study data indicated <u>less</u> health care utilization among residents of CCRCs. Why?

- Comparative studies are needed to determine not only differences in the cost of health care but what is being bought with the health care dollar: physician usage; skilled nursing and nurse practitioners' utilization; drugs; laboratory tests, and the need for additional recognized services such as podiatry and dental care. Data are also needed on health care expenditures by CCRC residents compared to expenditures by comparable groups living outside CCRCs.

- Does the immediate availability of health services in a CCRC produce better health among residents?

- What are the economies of scale in a CCRC?

- There is a definite need for development of a national, or regional, data base to be used as a guideline in selecting the assumptions to be used for financial analyses of CCRCs. Development of CCRC mortality rates is especially needed because it is impossible to reflect the financial consequences of a continuing care contract with accuracy using only life expectancies and mortality rates.

- How will CCRCs be affected by federal and state tax laws?

- What bio-ethical and legal questions will arise as a result of the increasing age of CCRC residents?

- Is discrimination on the basis of age, race or religious affiliation being practiced by any CCRCs?

- Who will determine the allocation of decreasing resources?

- What are the legal impacts of Medicare and Medicaid decisions?

Appendix 2

REPORT OF THE TRUSTEE OF PACIFIC HOMES

PURSUANT TO SECTIONS 167(1), (3) and (5) OF THE BANKRUPTCY ACT and CHAPTER X RULE 10-208(a)(4), (a)(5) and (a)(7)

RICHARD E. MATTHEWS
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October 15, 1979

I.

WHAT CAUSED THE PACIFIC HOMES DEBACLE?

THE TRUSTEE'S CONCLUSIONS

For more than 25 years, Pacific Homes perpetrated a fraud on unsuspecting elderly people in the name of the Methodist Church. That fraud, which consisted of taking money in exchange for the promise to provide lifetime care, but then diverting that money for the payment of current obligations instead of reserving those funds for the future costs of that care is best characterized as a modern day "Ponzi" scheme.[1]

Pacific Homes' management, directors and the Methodist Church, which controlled and directed Pacific Homes, were aware of the magnitude of the scheme and took active steps to encourage it and, simultaneously, to conceal it from the public. The essence of the scheme was the sale of prepaid lifetime leases and prepaid contracts for lifetime care to elderly persons who then became residents in one of the seven Pacific Homes retirement and convalescent communities. Residents were promised that by prepaying large sums of money they would have "permanent security, including complete medical and surgical care underwritten by Pacific Homes, a non-profit corporation of the Methodist Church". For the rest of their lives, residents were told, they could "forget inflation" by payment of fees "that can never be increased once you become a resident". Then, instead of reserving and investing these substantial cash pre-payments prudently, so they would be available in the future when needed to provide the services promised, the funds were diverted for expansion, speculative investments and payment of current operating losses. Since money was then needed to pay for the care of those residents whose funds had been squandered, more prepaid lifetime leases and care contracts were sold to raise cash. The scheme continued so long as enough new people could be induced to enter into the contracts.

Pacific Homes was in financial difficulty continuously for over 25 years before finally filing for protection under the Bankruptcy Act in 1977. The causes of that difficulty were multiple, interrelated and protracted:

1. Failing to establish adequate reserves to meet liabilities for future contracted care to residents;

2. Expanding facilities to meet Church missions without adequate financing;

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[1] A "Ponzi" scheme is a fundamental type of fraud. It is based on taking money from investors on the promise of repaying huge returns and then paying off early investors with funds taken in from more recent investors. The scheme eventually collapses when not enough new investors are found to cover payments due. The scheme was played so sensationally by Charles Ponzi in 1919-1920, that it has been named for him ever since. A brief description of Ponzi's scheme is contained in Exhibit I of the Appendix.

3. Using prepaid life care funds to finance current operating deficits and expansion;

4. Encumbering assets for long-term borrowing without the ability to repay the loans, then using the borrowed funds to support operating deficits; and

5. Engaging in ill-conceived, speculative and ultimately disastrous investments, often to further Church missions, by the use of funds which should have been reserved to meet future life care liabilities.

The final collapse is directly traceable to gross mismanagement over an extended period of time. The continuous acts of mismanagement, negligence, waste and breach of fiduciary duties were known to, and officially sanctioned by, the Methodist Church which controlled Pacific Homes from its inception. Furthermore the management of Pacific Homes allowed outside pressures from the Methodist Church and its subordinate agencies to so dominate and control Pacific Homes' affairs that normal business judgment was replaced by philosophical and religious concerns that ignored the importance of fiscal responsibility. As the consequences of these acts became apparent to management and Church officials, causing increasing financial crisis for Pacific Homes, those responsible for the operation consciously and deliberately concealed the true state of affairs from the public in order to continue the "Ponzi" scheme of selling more prepaid life care contracts.

In the operation of its retirement communities, Pacific Homes was guilty of not maintaining adequate and commercially appropriate financial reserves since 1954. Since 1965, Pacific Homes was in violation of the State of California's mandated reserve requirements. By 1969, Pacific Homes had a deficit net worth of over $17 million and management was contemplating bankruptcy. However, these facts were concealed from new residents and the public and Pacific Homes operations continued. The deficit grew to over $27 million by 1976.

How could the business have continued for so long a period of time under these conditions? Only because the Methodist Church directed the policies of Pacific Homes which included borrowing funds without the ability to repay, enticing elderly persons into residency by using the name of the Methodist Church, perpetuating the "Ponzi" scheme of selling prepaid life care contracts to fund current operations and expansion and concealing the true condition of the situation from residents, lenders and the general public. The more deeply Pacific Homes sank towards eventual bankruptcy, the more frantic were the efforts to borrow, to sell even more prepaid life care contracts in the name of the Methodist Church, and to conceal the losses and disastrous investments.

The State of California shares responsibility for the continuation of this fraud. By 1965, the State was aware that Pacific Homes was deficient in meeting its statutory reserve requirements and should have revoked Pacific Homes authority to sell life care contracts. Instead, the State ignored its mandatory duty, and allowed Pacific Homes to continue the "Ponzi" scheme right up to the day it filed for bankruptcy.[2]

Pacific Homes has always been a Methodist institution. It has always complied with the dictates of the Methodist Church and carried out Church missions without regard to economic consequences. The Methodist Church sanctioned the policies and actions of Pacific Homes, was fully informed of the financial problems for many years and encouraged Pacific Homes to present itself to the public as a Methodist agency. Instead of taking appropriate action to correct the problems at Pacific Homes, the Church allowed the same business practices to continue despite the knowledge that such continuance could only worsen the financial condition of Pacific Homes and add to the injuries and damages sustained.

The Methodist Church allowed Pacific Homes to fail. The Church should not be allowed to escape liability for the wrongs it has wrought. Legal actions have already been instituted against the Methodist Church by the Trustee and by the residents of the homes.[3]

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[2] The Pacific Homes debacle may well be the longest running, largest Ponzi scheme in history. The original scheme, run by Charles Ponzi in 1919-20, lasted eight months and resulted in losses to investors of approximately $4 million. Other schemes have been exposed in the years since, some resulting in investor losses in excess of $100 million. In 1973, when the Home-Stake Production Company went bankrupt it was revealed that nearly $100 million had been lost by investors over a 9 year period in an oil-drilling Ponzi scheme. The Pacific Homes fraud went on for over 25 years, involved several thousand resident-investors and has resulted in law suits claiming more than $200 million in damages.

[3] See Infra, Chapter VIII.

Appendix 3

Kirkwood by the River	Birmingham	AL
Mount Royal Towers, Inc.	Birmingham	AL
* Friendship Village	Tempe	AZ
Orangewood Retirement Community	Phoenix	AZ
Aldersly, Inc.	San Rafael	CA
The Alhambra	Alhambra	CA
Brethren Hillcrest Homes, Inc.	La Verne	CA
Canterbury Woods	Pacific Grove	CA
Carlsbad-by-the-Sea	Carlsbad	CA
Carmel Valley Manor, Inc.	Carmel	CA
Casa Dorinda	Montecito	CA
Channing House	Palo Alto	CA
Covenant Village	Turlock	CA
Forest Hill Manor	Pacific Grove	CA
Grand Lake Gardens	Oakland	CA
The Heritage	San Francisco	CA
Lake Park Retirement Home	Oakland	CA
Los Gatos Meadows	Los Gatos	CA
Mount Miguel Covenant Village	Spring Valley	CA
Mt. San Antonio Gardens	Pomona	CA
Piedmont Gardens	Oakland	CA
Pilgrim Haven	Los Altos	CA
* Plymouth Village of Redlands	Redlands	CA
* Rosewood Retirement Community	Bakersfield	CA
Quaker Gardens	Stanton	CA
Regents Point	Irvine	CA
Royal Oaks Manor	Duarte	CA
St. Paul's Towers	Oakland	CA
The Samarkand of Santa Barbara, Inc	Santa Barbara	CA
San Joaquin Gardens	Fresno	CA
The Scripps Home	Altadena	CA
The Sequoias-Portola Valley	Portola Valley	CA
The Sequoias-San Francisco	San Francisco	CA
* Solheim Lutheran Home	Los Angeles	CA
Sunny View Lutheran Home	Cupertino	CA
The Tamalpais	Greenbrae	CA
The Valle Verde Retirement Center	Santa Barbara	CA
* White Sands of La Jolla	La Jolla	CA
Windsor Manor	Glendale	CA
Frasier Meadows Manor	Boulder	CO
* Medalion Retirement Center	Colorado Springs	CO
* Medalion West	Colorado Springs	CO
* Sunny Acres Villa	Denver	CO
* Villa Pueblo Towers	Pueblo	CO
* Covenant Village and Pilgrim Manor	Cromwell	CT
Thirty Thirty Park	Bridgeport	CT
Whitney Center, Inc.	Hamden	CT
Cokesbury Village	Hockessin	DE

	Lisner-Louise Home	Washington	DC
*	Presbyterian Home of DC	Washington	DC
*	Thomas House	Washington	DC
	Abbey Delray	Delray Beach	FL
	Asbury Towers	Brandenton	FL
	Azalea Trace	Pensacola	FL
	Bay Village of Sarasota, Inc.	Sarasota	FL
	Bradenton Manor	Bradenton	FL
	Calusa Retirement Center	Fort Myers	FL
	Canterbury Tower, Inc.	Tampa	FL
*	Congregational House	Clearwater	FL
	Covenant Palms of Miami	Miami	FL
	Covenant Village of Florida	Plantation	FL
	East Ridge Retirement Village, Inc.	Miami	FL
	Evergreen Woods	Springhill	FL
	Jacksonville Regency House	Jacksonville	FL
*	John Knox Village of Central Florida	Orange City	FL
	John Knox Village of Florida, Inc.	Pompano Beach	FL
*	John Knox Village of Margate	Margate	FL
*	John Knox Village of Tampa Bay	Tampa	FL
	Leisure Manor	St. Petersburg	FL
	Moorings Park	Naples	FL
	Oak Bluffs Retirement Center	Clearwater	FL
	Oak Cove Retirement & Health Center	Clearwater	FL
	Orlando Lutheran Towers	Orlando	FL
	Palm Shores Retirement Center	St. Petersburg	FL
	Plymouth Harbor, Inc.	Sarasota	FL
	St. Andrews Estates	Boca Raton	FL
*	St. Mark Village	Palm Harbor	FL
	Shell Point Village	Fort Myers	FL
	The Shores	Bradenton	FL
*	Trinity Lakes	Sun City Center	FL
	The Waterford	Juno Beach	FL
	Westminster Oaks	Tallahassee	FL
	Westminster Towers	Orlando	FL
	Winter Park Towers & Village	Winter Park	FL
*	Arcadia Retirement Residence	Honolulu	HA
	Apt. Community of Our Lady of the Snows	Belleville	IL
	Bensenville Home Society	Bensenville	IL
*	Bethany Home and Hospital	Chicago	IL
	Covenant Village - Northbrook	Northbrook	IL
*	Danish Old Peoples' Home	Chicago	IL
	Evenglow Lodge	Pontiac	IL
	Friendship Manor	Rock Island	IL
*	Friendship Village of Schaumburg	Schaumburg	IL
	The Georgian	Evanston	IL
	The Holmstad	Batavia	IL
	Plymouth Place, Inc.	LaGrande Park	IL
	The Presbyterian Home	Evanston	IL
*	The Scottish Home	North Riverside	IL
	Wesley Willows	Rockford	IL

*	Westminster Place	Evanston	IL
	Westminster Village–Bloomington	Bloomington	IL
	Altenheim Community	Indianapolis	IN
	Asbury Towers	Greencastle	IN
	The Four Seasons Retirement Center	Columbus	IN
*	Franklin United Methodist Home	Franklin	IN
*	Friends' Fellowship Community	Richmond	IN
	Hoosier Village Retirement Center	Indianapolis	IN
	Topsfield Terrace Retirement Community	South Bend	IN
	The Towne House	Fort Wayne	IN
	United Methodist Memorial Home	Warren	IN
	Calvin Manor	Des Moines	IA
*	Cedar Falls Lutheran Church	Cedar Falls	IA
	Friendship Village–Waterloo	Waterloo	IA
	Heather Manor	Des Moines	IA
	Heritage House	Atlantic	IA
	Meth-Wick Manor	Cedar Rapids	IA
	Northcrest Community	Ames	IA
*	Oaknoll Retirement Residence	Iowa City	IA
	Ridgecrest Retirement Village	Davenport	IA
	United Presbyterian Home	Washington	IA
	Valley View Village	Des Moines	IA
	Wesley Acres	Des Moines	IA
*	Aldersgate Village	Topeka	KS
	Arkansas City Presbyterian Manor	Arkansas City	KS
	Brewster Place	Topeka	KS
	Lakeview Village	Lenexa	KS
	Lawrence Presbyterian Manor	Lawrence	KS
	Presbyterian Manor of Kansas City	Kansas City	KS
	Salina Presbyterian Manor, Inc.	Salina	KS
	Sterling Presbyterian Manor	Sterling	KS
	Wesley Towers, Inc.	Hutchinson	KS
	Wichita Presbyterian Manor	Wichita	KS
*	St. James Place	Baton Rouge	LA
*	Asbury Methodist Home	Gaithersburg	MD
*	Augsburg Lutheran Home	Baltimore	MD
*	Broadmead	Cockeysville	MD
	Fairhaven	Sykesville	MD
	Friendship Village Kalamazoo	Kalamazoo	MI
	Glacier Hills	Ann Arbor	MI
	Independence Village	Frankenmuth	MI
	Inter-City Christian Manor	Allen Park	MI
	Vista Grande Villa	Jackson	MI
	Covenant Manor Retirement Community	Minneapolis	MN
	Friendship Village of Bloomington	Bloomington	MN
	Madonna Towers	Rochester	MN
	Thorne–Crest Retirement Center	Albert Lea	MN

	The Charless Home	St. Louis	MO
*	Friendship Village of South County	St. Louis	MO
	Friendship Village of West County	Chesterfield	MO
	Fulton Presbyterian Manor	Fulton	MO
	John Knox Village	Lee's Summit	MO
*	John Knox Village East	Higginsville	MO
*	John Knox Village of the Ozarks	Waynesville	MO
*	Presbyterian Manor at Farmington	Farmington	MO
	Rolla Presbyterian Manor	Rolla	MO
	St. Louis Altenheim	St. Louis	MO
	Vista del Rio	Kansas City	MO
*	Eastmont Towers	Lincoln	NE
	Gateway Manor, Inc.	Lincoln	NE
	Northfield Villa, Inc.	Gering	NE
*	Skyline Manor	Omaha	NE
	Home for Aged Women	Portsmouth	NH
	Cadbury	Cherry Hill	NJ
	Meadow Lakes	Princeton	NJ
	Medford Leas	Medford	NJ
	Navesink House	Red Bank	NJ
	Workmen's Circle Home for the Aged	Elizabeth	NJ
*	El Castillo Retirement Residence	Santa Fe	NM
	Landsun Homes, Inc.	Carlsbad	NM
	J. W. Abernethy Center	Newtown	NC
	Carol Woods Retirement Community	Chapel Hill	NC
*	Carolina Village	Hendersonville	NC
*	Episcopal Home for the Aging	Southern Pines	NC
	The Methodist Home	Charlotte	NC
*	Moravian Home, Inc.	Winston-Salem	NC
	The Presbyterian Home, Inc.	High Point	NC
*	The Presbyterian Home at Charlotte	Charlotte	NC
	Bethesda Scarlet Oaks Retirement Community	Cincinnati	OH
	Breckenridge Village	Willoughby	OH
	Copeland Oaks	Sebring	OH
	Dorothy Love Retirement Community	Sidney	OH
*	First Community Village	Columbus	OH
*	Friends Care Center of Yellow Springs	Yellow Springs	OH
	Friendship Village of Columbus	Columbus	OH
*	Friendship Village of Dayton	Dayton	OH
	Friendship Village of Dublin	Dublin	OH
*	Hill View Retirement Center	Portsmouth	OH
	Judson Park	Cleveland Hgts	OH
	Maple Knoll Village	Springdale	OH
	The Marjorie P. Lee Home	Cincinnati	OH
	Methodist Home on College Hill	Cincinnati	OH
	Otterbein Home	Lebanon	OH
	Mt. Pleasant Retirement Village	Monroe	OH
	Park Vista Presbyterian Home	Youngstown	OH

	Portage Valley Retirement Village	Pemberville	OH
	Rockynol	Akron	OH
*	Trinity Home	Dayton	OH
	Wesley Glen, Inc.	Columbus	OH
	Westminster Thurber Community	Columbus	OH
	Okla. Christian Home/Okla. Christian Apts.	Edmond	OK
	Cascade Manor	Eugene	OR
	Friendsview Manor	Newberg	OR
	Holladay Park Plaza	Portland	OR
	Rogue Valley Manor, Inc.	Medford	OR
*	Rose Villa, Inc.	Portland	OR
*	Willamette View Manor	Portland	OR
	Calvary Fellowship Homes, Inc.	Lancaster	PA
	Cathedral Village	Philadelphia	PA
	Crosslands	Kennett Square	PA
	Cross Keys Village	New Oxford	PA
	Dunwoody Village	Newtown Square	PA
*	Gloria Dei Village	Holland	PA
	Fiddler's Woods	Philadelphia	PA
	Fort Washington Estates	Fort Washington	PA
	Foulkeways at Gwynedd	Gwynedd	PA
	Friendship Village of South Hill	Upper St. Clair	PA
	Green Ridge Village	Dillsburg	PA
	Gwynedd Estates	Springhouse	PA
*	Heritage Towers	Dolyestown	PA
	Kendal at Longwood	Kennett Square	PA
	Lima Estates	Lima	PA
*	Martin's Run	Marple Township	PA
	Messiah Village	Mechanicsburg	PA
	Paul's Run	Philadelphia	PA
	Pennswood Village, Inc.	Newtown	PA
	Philadelphia Protestant Home	Philadelphia	PA
	Pine Run	Doylestown	PA
	Rosemont Presbyterian Village	Rosemont	PA
	Rydal Park	Rydal	PA
	Sarah A. Reed Home - Retirement Center	Erie	PA
*	Sherwood Oaks	Wexford	PA
*	Simpson House	Philadephia	PA
	Southampton Estates	Southampton	PA
	Spring House Estates	Springhouse	PA
*	Springfield Retirement Residence	Wyndmoor	PA
	The Village at St. Barnabas	Gibsonia	PA
*	Wood River Village	Bensalem	PA
	McKendree Manor, Inc.	Hermitage	TN
*	Shannondale	Knoxville	TN
	The Trezevant Episcopal Home	Memphis	TN
*	Bayou Manor	Houston	TX
*	The Hallmark	Houston	TX
*	John Knox Village of Metroplex	Denton	TX

	John Knox Village of the Rio Grand Valley	Weslaco	TX
	John Knox Village of West Texas	Lubbock	TX
	Presbyterian Village North, Inc.	Dallas	TX
*	Westminster Manor	Austin	TX
	Goodwin House	Alexandria	VA
*	Hermitage in Northern Virginia	Alexandria	VA
	Hermitage Home of Richmond	Richmond	VA
*	Hermitage on the Eastern Shore	Onancock	VA
	Lakewood Manor	Richmond	VA
*	Masonic Home of Virginia	Richmond	VA
	United Methodist Home in Roanoke	Roanoke	VA
	Virginia Baptist Homes-Culpeper	Culpeper	VA
	Westminster-Canterbury in Virginia Beach	Virginia Beach	VA
	Westminster Canterbury Corporation	Richmond	VA
	Westminster-Canterbury of Lynchburg, Inc.	Lynchburg	VA
	Bayview Manor	Seattle	WA
	Covenant Shores, Inc.	Mercer Island	WA
	The Frank Tobey Jones Home	Tacoma	WA
	The Hearthstone	Seattle	WA
	Horizon House, Inc.	Seattle	WA
*	Judson Park Retirement Residence	Seattle	WA
	Riverview Terrace	Spokane	WA
	Alexian Village of Milwaukee	Milwaukee	WI
	Evergreen Manor, Inc.	Oshkosh	WI
	Fairhaven Corporation	Whitewater	WI
*	Friendship Village of Milwaukee	Milwaukee	WI
	Methodist Manor, Inc.	West Allis	WI
	Milwaukee Catholic Home, Inc.	Milwaukee	WI
	Milwaukee Protestant Home for the Aged	Milwaukee	WI
	St. John's Home of Milwaukee	Milwaukee	WI
	Tudor Oaks Retirement Community	Hales Corners	WI

ITEM 2. CONGRESSIONAL RESEARCH SERVICE MEMORANDUM CONCERNING STATE REGULATION OF LIFE CARE COMMUNITIES

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

STATE STATUTORY REQUIREMENTS WITH REGARD TO THE REGULATION OF "LIFE CARE" OR "CONTINUING CARE" COMMUNITIES FOR THE ELDERLY

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May 11, 1983

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STATE STATUTORY REQUIREMENTS WITH REGARD TO THE REGULATION OF "LIFE CARE" OR "CONTINUING CARE" COMMUNITITES FOR THE ELDERLY

I. INTRODUCTION

The concept of life care contracts has largely developed over the past ten years in response to the rapidly growing numbers of elderly persons confronted with the problem of acquiring suitable housing accommodations that will provide them with the types of support services which they require at reasonable prices. As the unavailability and inaccessibility of affordable medical care and housing for the elderly continues to grow as a major social issue of national importance, America's elderly population will continue to seek viable alternatives to the traditional nursing home environment. As one legal commentator has noted, life care communities offer older Americans significant advantages over the more traditional forms of congregate housing in that they preserve the elements of independent living without the financial hardships attributable to ownership and without sacrificing affordable and readily available nursing care.[1/]

Although the terms and conditions of life care contracts may vary from facility to facility, these contracts characteristically consist of a formally executed legal document whereby an elderly person contracts for the provision of specified services in exchange for his or her payment of set fees and/or assets to a life care provider or facility. The contract will generally state the legal obligations and duties of the contracting parties, including the manner in which payment will be made and the types of accommodations and services

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1/ See, COMMENT, Continuing care communities for the elderly: potential pitfalls and proposed regulation, 128 UNIV. PENN. L. REV. 883, 891 (April 1980).

to be provided residents of the life care facility. It has been estimated that in 1982 more than 600 life care communities were in operation in the United States.[2/]

The perceived need for governmental regulation of life care institutions essentially arises from the financial and contractual nature of these business entities. For some elderly persons, membership in a life care community will often involve the liquidation of their entire financial resources. The strong potential for fraud or mismanagement of both the funds received by the life care providers, as well as the provision of contracted care and services, have been cited as major reasons why protective regulation of these facilities is warranted. A diminishing cash reserve may inevitably lead to the financial insolvency of the community and the resulting abandonment of elderly persons left without money, housing, and much needed medical and nursing care. One case in point is the somewhat recent bankruptcy of Pacific Homes, a California corporation operating life care communities mainly in the States of California and Arizona. The financial disaster of this life care community generated a series of major lawsuits on behalf of both residents and bond purchasers.[3/]

Eleven states (Arizona, California, Colorado, Florida, Illinois, Indiana, Maryland, Michigan, Minnesota, Missouri, Oregon) have enacted statutory provisions specifically designed to regulate these entities; and among these states not all of the statutes provide an extensive statutory scheme for regulating life care communities. This report provides brief

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2/ Laventhol & Horwath, Life care industry: second annual report on the life care industry in the United States (1982 ed.), p. 3.

3/ See esp., Barr v. United Methodist Church, 82 C.A.3d 72 (June 23, 1980) (class action on behalf of residents for breach of contract and fraud).

summaries of the major statutory requirements or provisions of each state statute. Copies of the specific statutes are not provided; however, they may be found in the relevant state codes. Citations to the location of these laws in the respective state codes are included at the beginning of each state summary. Each statutory summary also provides specific indications of: (A) the state governmental agency that administers the statute; (B) the specific types of care or services that are included in the statutory definitions of the terms "life care, " "continuing care," or analogous terms; and (C) the statutory definitions of the terms "life care contract," "continuing care contract," or analogous terms.

II. SUMMARIES OF STATE STATUTORY REQUIREMENTS FOR THE REGULATION OF "LIFE CARE" OR "CONTINUING CARE" COMMUNITIES FOR THE ELDERLY

ARIZONA - Arizona Revised Stats. Ann. § 20-1801 et seq.
("Life Care Contracts;" effective January 1, 1978)

A. Responsible governmental agency: Arizona Department of Insurance

B. Services included in the definition of "life care," "continuing care," or "care": nursing services, medical services or health-related services, in addition to board and lodging.

C. Definition of term "life care contract," "continuing care contract," and analogous terms: a contract to provide to a person for the duration of such person's life or for a term in excess of one year, nursing services, medical services or health-related services in addition to board and lodging, for such person in a facility, conditioned upon the transfer of an entrance fee to the provider of such services in addition to or in lieu of the payment of regular periodic charges for the care and service, involved (§ 20-1801(5)).

D. Major statutory provisions:

1. Requirement that provider must apply to the Department of Insurance for a permit to enter into life care contracts. Application must minimally contain information with regard to the terms and conditions of the life care contracts; the name and address of applicant, and the names of members of the board of directors, trustees, or the managing partners if the applicant is other than an individual; business experience of applicant in the operation of similar facilities; anticipated number of residents at facility; financial interests in other legal entities; affiliations with religious, charitable, or nonprofit organizations; judicial or administrative actions taken against the applicant, or other manager if facility will be managed on a day-to-day basis by a corporation other than the applicant, or a principal, or a parent company, or a subsidiary corporation, or an affiliate, arising out of business activity or health care; anticipated source and application of funds for future purchase or construction of a facility; applicant's financial status, including projected annual income statements; measure that have been taken or will be taken by applicant to provide reserve funding or security to enable him or her to fully perform his obligations under life care contracts; a statement of periodic rates to be initially paid by residents; a statement of the terms and conditions under which a life care contract may be cancelled by the provider or the resident (§§ 20-1802, 20-1803).

2. Requirement that persons entering into life care contracts shall have seven days to rescind the life care contract without penalty or further obligation (§ 20-1802).

3. Requirement that the provider shall deliver to the persons entering into life care contracts a copy of the provider's permit application or most recent annual report, whichever is most recent (§ 20-1802).

4. Requirement that provider must file an annual report (including information described in # 1 above) with the Department of Insurance (§ 20-1807).

5. Requirement that provider must establish an escrow account for entrance fees (§ 20-1804).

6. Requirement that provider must establish a reserve fund escrow account (§ 20-1806).

7. Requirement that State Insurance Director must record with the county recorder of any county a notice of lien on behalf of all residents who enter into life care contracts with applicant on the land and improvements owned by the provider (§ 20-1805).

8. Provision establishing formal judicial procedure for rehabilitation of a provider in the event that his or her financial condition becomes unsound or unsafe (§ 20-1808).

9. Provision authorizing State Insurance Director to conduct examinations of the affairs of any provider (§ 20-1809).

10. Prohibition against the transfer of permits (§ 20-1802).

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CALIFORNIA - West's Annot. California Codes, Health and Safety Code § 1770 et seq. ("Supervision of Life Care Contracts;" effective July 1, 1978)

A. Responsible governmental agency: California Department of Social Services

B. Services included in the definition of "life care," "continuing care," or "care": nursing services, medical services, health-related services, board and lodging and care as necessary, or any combination of such services (§ 1771).

C. Definition of term "life care contract," "continuing care contract," or analogous term: (a) life care contract - a contract to provide a person for the duration of such person's life or for a term in excess of one year, nursing services, medical services, or health-related services, board and lodging and care as necessary, or any combination of such services, for such person in a facility, which may be conditioned upon the transfer of an entrance fee to the provider of such services in addition to or in lieu of the payment of regular periodic charges for the care and services involved, and includes continuing care agreements; (b) prepaid life care contract - means a life care contract under which the advance payment, including any entrance fee, is more than nine times the annual amount of the monthly care fee or 108 times the monthly care fee (§ 1771).

D. Major statutory provisions:

1. Requirement that life care providers must be granted a certificate of authority by the Department of Social Services and have received a written license pursuant to Chapter 2 (Licensing of Health Facilities) or Chapter 3 (Licensing of Community Care Facilities) of the California Health and Safety Code. The application for the issuance of a certificate of authority must minimally include the following information: certified financial statements of the applicant as of a date not more than 90 days prior to the date the statements are filed; a projected annual income statement including certain statutorily specified information; a description of the manner in which reserve funds will be invested and the persons who will be making the investment decisions; copies of any escrow agreements executed by the provider; the name and business address of the applicant; name, address and physical description of the property of the facility; a statement of the terms and conditions under which life care contracts will be entered; if applicant is a legal entity other than an individual, a statement naming the type of such entity and a listing of the interest and extent of such interest of each principal in the legal entity; the estimated number of residents to be provided services by the applicant under life care contracts; a statement of the provisions that have been made by the provider to provide reserve funding or security to enable him or her to meet contractual obligations; applicant's affiliations with any religious, charitable or other nonprofit organization; if applicant is a subsidiary corporation, the names and primary activities of the parent corpora-

tion; a description of the business experience of the applicant in the operation of similar facilities; a statement of whether the applicant or other statutorily designated legal entities or persons affiliated with the applicant has been involved in any of the statutorily specified civil or administrative actions arising out of applicant's business activities related to the provision of health care; a statement of the periodic rates to be charged residents; a statement of anticipated sources and application of funds for future purchases, leases, rentals, or construction, if such activity has not yet begun (§§ 1771.3, 1771.4, 1771.5, 1771.6, 1771.8).

2. Provisions authorizing the Department of Social Services to record with the recorder of any county a notice of lien on behalf of life care recipients when it is necessary to secure the performance of all obligations of the life care provider to the recipients (§ 1772).

3. Requirement that provider furnish surety bonds for employees having access to substantial amounts of funds in the course of his or her agency or employment (§ 1774).

4. Requirement that applicant must establish a reserve escrow account, as specified under the statute, with an escrow agent (§§ 1774.4, 1774.5).

5. Requirement that obligations incurred by a provider pursuant to life care agreements shall be deemed a preferred claim against all assets owned by the provider in the event of liquidation (§ 1777).

6. Requirement that all agreements entered into between the provider and the life care recipient must be in writing and contain statutorily specified information (§§ 1778, 1779).

7. Requirement that all contract forms used by provider shall be approved by the Department of Social Services prior to their use by the provider (§ 1778).

8. Requirement that persons or organizations receiving a certificate of authority must maintain statutorily specified reserves covering obligations assumed under all agreements entered into and maintained (§ 1775).

9. Provisions establishing formal judicial procedures for the rehabilitation or liquidation and dissolution of a provider if the provider is in a financially unsafe or unsound condition (§§ 1790 thru 1790.6).

10. Establishment of a Life Care Contract Advisory Board which shall advise the Department of Social Services on matters affecting life care programs. (§§ 1791 thru 1791.6).

11. Statement of the terms and conditions under which a contract may be cancelled and under which a person may be discharged from a facility prior to the expiration of the contract (§ 1779.3 thru 1780).

12. Provision authorizing the Department of Social Services to inspect or examine the business affairs of a life care provider (§ 1781).

13. Establishment of a 90-day period during which a life care contract may be cancelled (§ 1779.3).

14. Requirement that each life care provider must file with the department, and provide to life care recipients upon request, an annual audit of its financial affairs within four months after the end of the provider's fiscal year (§ 1782.5, 1783).

15. Statement of the duration of a certificate of authority and the procedures and circumstances under which a certificate may be suspended, limited, or revoked by the Department of Social Services (§§ 1783, 1784, 1785).

16. Prohibitions against the transfer of a certificate of authority, the alteration of the terms of a life care contract, and the location of the place in which the contract is to be performed (§ 1786).

17. Requirement that the Department of Social Services must approve any transfer of ownership of a life care facility (§ 1787).

18. Provision authorizing individuals and corporations planning to construct a life care facility using deposits from potential residents to apply to the department for a permit to sell deposit subscriptions (§ 1773.5).

19. Prohibition against the use of the names of third parties (including individuals, corporations, or religious or charitable organizations) in advertising communications, financial statements, oral representations or any printed matter designed to solicit or induce persons to enter into a life care contract unless a written statement from said party, stating his acceptance of full responsibility and liability for any such contract is on file with the Department of Social Services (§ 1789).

20. Criminal and civil penalty provisions (§§ 1788, 1789.5).

COLORADO - Colorado 1981 Session Laws, Chapter 125 § 12-13-101 et seq. ("Life Care Institutions"; effective July 1, 1981)

A. Responsible governmental agency: Colorado Insurance Commission

B. Services included in the definition of "life care," "continuing care," or "care": care including but not limited to services such as health care, medical services, board, lodging, or other necessities (§12-13-101(5)).

C. Definition of term "life care contract", "continuing care contract," or analogous terms: a written contract to provide life care to a a person for the duration of such person's life conditioned upon the transfer of an entrance fee to the provider of such services in addition to or in lieu of the payment of regular periodic charges for the care and services involved (§12-13-101(6)).

D. Major statutory provisions:

1. Requirement that no person shall construct, expand, acquire, maintain, or conduct a facility for the purpose of offering life care, or enter into or modify a life care contract without a certificate of authority granted by the State Insurance Commissioner. Applications for certificates must minimally include: a copy of the proposed form of life care contract to be entered into with residents of the facility; name and address of the applicant and of the applicant's agent for service of process in the State of Colorado; name, address, and physical description of the physical property of the facility; terms and conditions of the life care contracts to be used; estimated numbers of residents of the facility to be provided services under life care contracts; statements disclosing the nature and extent of any contracts between the applicant and third-party service providers; a statement of provisions made by the applicant to provide reserve funding or security to enable the applicant to fully perform his legal obligations under life care contracts; a statement of the applicant's affiliation or contractual relationship with religious, charitable, or other nonprofit organizations; where relevant, statements identifying applicant's parent corporation or other affiliate corporations, including information with regard to the nature of such affiliations; a description of the applicant's business experience; projected annual income statements for the facility for a period not less than five years; a statement of the anticipated source and application of the funds used or to be used in the purchase or construction of the facility if operation of the

facility has not yet begun; applicant's financial statement that has been audited by an independent certified public accountant (§ 12-13-102).

2. Requirement that persons entering into life care contracts shall have sixty days within which to rescind the contract without penalty or further obligation (§ 12-13-102).

3. Requirement that life contracts must contain or be accompanied by certain minimal information specified by statute (§ 12-13-114).

4. Requirement that commissioner must, as a condition to granting a certificate of authority to an applicant, record a lien on behalf of persons entering into life care contracts with the applicant to secure performance of the provider's obligations under life care contracts (§ 12-13-106).

5. Requirement that provider must deliver to persons entering into life care contracts, prior to the execution of a contract and the transfer of any money or property, a copy of the provider's certificate of authority application or the provider's most recent annual report (§ 12-13-102).

6. Prohibition against the transfer of any certificate of authority; prohibition against the sale or transfer of ownership of a life care facility or the entering into any contract with a third-party service provider for management of the facility, unless the commissioner has approved such transfer or contract (§ 12-13-103).

7. Requirement that all providers must establish an escrow account for entrance fees in a bank, trust company, or other licensed corporate escrow agent in Corlorado that has been approved by the commissioner (§ 12-13104).

8. Statement of the manner in which refunds must be made to residents in the event of their withdrawal or dismissal from a life care facility (§ 12-13-105).

9. Statement of the circumstances under which a certificate may be denied by the commissioner (§ 12-13-103).

10. Requirement that each provider must maintain statutorily specified reserves covering obligations under all life care agreements (§ 12-13-107).

11. Requirement that each provider must file an annual report and application for renewal of its certificate with the commissioner (§ 12-13-108).

12. Establishment of a formal judicial procedure whereby a financially unsound life care provider may be rehabilitated by the insurance commissioner (§ 12-13-109).

13. Requirement that every certificate holder must maintain a register setting forth statutorily specified information with regard to each person residing in the life care facility (§ 12-13-115).

14. Requirement that advertisements and solicitations of life care facilities must clearly state the extent of financial responsibility assumed by individuals or organizations listed or referred to as being connected with the person, association, or corporation who is to perform the contract (§ 12-13-116).

15. Provision authorizing the commissioner to conduct examinations into the affairs of life care providers (§ 12-13-110).

16. Injunction and criminal prosecution provisions (§ 12-13-117).

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FLORIDA - West's Florida Stats. Ann. § 651.001 et seq. ("Life Care Contracts"; effective July 1, 1977)

A. Responsible governmental agency: Florida State Department of Insurance (statute also establishes a Continuing Care Advisory Council to act in an advisory capacity to the Insurance Department (§ 651.121)).

B. Services included in the definition of "life care", "continuing care", or "care": shelter, food, and either nursing care or personal services, whether such nursing care or personal services are provided in the facility or in another setting designated by the agreement (§ 651.011(2)).

C. Definition of term "life care contract," "continuing care contract," or analogous term: (a) life care - a life lease, life membership, life estate, or similar agreement between a member and a provider by which the member pays a fee for the right to occupy a space in a designated facility for life (§651.011), (b) care for a term of years - means an agreement between a member and a provider whereby the member pays a fee for the right to occupy space in a designated facility, and to receive continuing care, for at least 1 year, but for less than the life of the member (§ 651.011).

D. Major statutory provisions:

1. Requirement that providers of continuing care must obtain a certificate of authority from the Department of Insurance. Application for certificate must include an annual statement that includes at least information with regard to: name and address of applicant, facility, proprietor(s), trustees, managers, major stockholders, or other specified individuals having a financial interest in the facility or in another entity providing goods or services to the facility; types of continuing care agreements to be entered into by provider; financial statements that have been audited by a certified public accountant (including statutorily specified financial information); the location and description of physical property to be used in connection with the provision of continuing care; evidence that the applicant is of reputable and responsible character; statements of whether a person identified in the application, or the administrator of the facility, has been subject to specified criminal, civil, or administrative actions. (§ 651.026).

2. Requirement that persons intending to enter into the offering of continuing health care agreements shall apply to the Department of Insurance for provisional certificate of authority and that if granted applicant must perform a feasibility study to be submitted to the Department with the final application for a certificate of authority (§ 651.031).

3. Requirement that provider shall maintain an escrow account (§§ 651.033, 651.035).

4. Prohibition against the removal of records of assets by provider from the State of Florida unless the Department of Insurance consents in writing to such removal (§651.0951).

5. Statement of specific provisions to be contained in life care agreements, including terms and conditions with regard to a resident's right to rescind the agreement (§651.055).

6. Statement of conditions under which a member or resident may be dismissed or discharged from a facility (§651.061).

7. Statement of the amount of preference to be accorded continuing care agreements in the event of the liquidation of the provider (§651.071).

8. Statement of the rights of members of a facility to self-organize, to be represented by an individual of their choosing, and to engage in concerted activities (§651.081).

9. Requirement that quarterly meetings be held between members and the governing body of the facility (§651.085).

10. Statement as to the availability to the public of reports, annual statements, and other documents of a continuing care facility (§651.091).

11. Requirements for Department of Insurance approval of sales literature and advertising communications of continuing care providers (§651.095).

12. Provision authorizing commissioner to inspect and examine the business of providers and applicants for a certificate of authority (including provision granting interested persons the right to request state inspections and examinations of the records and financial affairs of a facility in connection with an alleged violation) (§§ 651.105, 654.111).

13. Statement of (a) the circumstances or grounds for which the Department of Insurance may refuse, suspend, or revoke a certificate of authority, and (b) the duration of a suspension, the provider's obligations during suspension, and the manner in which a certificate of authority may be reinstated (§§ 651.106, 651.107).

14. Criminal penalty, injunctive relief, and civil fine provisions, (§§ 651.125, 651.108).

ILLINOIS - Smith-Hurd Illinois Annot. Stats., Chapter 111 1/2, § 4160-1 et seq. ("Life Care Facilities Act"; effective January 1, 1982)

A. Responsible governmental agency: Illinois Department of Public Health

B. Services included in the definition of "life care", "continuing care," or "care": services pertaining to medical or dental care that are performed on behalf of patients at the direction of a licensed physician or under the supervision of a registered or licensed practical nurse; food, shelter, and laundry services; and services pertaining to medical or dental care that are performed on behalf of patients at the direction of a licensed physician, dentist, nurse, or by other professional and technical personnel.

C. Definition of terms "life care contract", "continuing care contract," or analogous terms: a contract to provide to a person for the duration of such person's life or for a term in excess of one year, nursing services, medical services or personal care services for such person in a facility, conditioned upon the transfer of an entrance fee to the provider of such services in addition to or in lieu of the payment of regular periodic charges for the care and services involved (§ 4160.2(c)).

D. Major statutory provisions:

1. Requirement that a provider must obtain a permit from the Department of Public Health to enter into a life care contract. Application must be signed and sworn under oath and must include attachments of a copy of the proposed form of life care contracts to be entered into with residents at the facility; a copy of the escrow agreement required by the act (see #4 below); and, a permit application fee of $100 (§§ 4160-3, 4160-4).

2. Provision of a 14 day period within which persons entering into life care contracts may rescind the contract without penalty or further obligation (§4160-5(b)).

3. Requirement that provider shall deliver to the resident a copy of provider's financial disclosure statement at the time of or prior to the execution of the contract and the transfer of any money or other property to a provider or escrow agent. Statement must minimally contain a disclosure of provider's assets and liabilities (§ 4160-5(a)).

4. Requirement that provider establish an escrow account at a bank, trust company or other financial institution in the State of Illinois as a condition for the issuance of a permit (§ 4160-7).

5. Provision authorizing the Director of Public Health to conduct audits and examinations of the financial affairs of a life care provider (§ 4160.10).

6. Criminal penalty provision (§ 4160-12).

7. Provision authorizing the Director of Public Health to deny, revoke, or suspend a permit for violations of the statute (§ 4160-11).

8. Provision authorizing the Director of Public Health to file an appropriate legal action on behalf of the State of Illinois or all residents of a facility, in a court of competent jurisdiction (including the federal bankruptcy court or other federal courts) at any time the Director has reason to believe that the provider is in danger of insolvency or is financially unable to fully perform his legal obligations pursuant to life care contracts (§ 4160-9).

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CRS-17

INDIANA - Burn's Indiana Statutes Ann. § 23-2-4-1 et seq. ("Supervision of Continuing Care Contracts"; effective September 1, 1983)

A. Responsible governmental agency: Indiana State Securities Commissioner

B. Services included in the definition of "life care," "continuing care," or "care": living accommodations, meals and related services in a home, together with nursing care services, medical services or health-related services (§ 23-2-4-1).

C. Definition of term "life care contract," "continuing care contract," or analogous terms: an agreement by a provider to furnish to an individual, for the payment of an entrance fee and periodic charges living accommodations, meals and related services in a home, together with nursing care services, medical services or other health-related services for the life of the individual or for more than one month (§ 23-2-4-1).

1. Requirement that facilities be registered with State Securities Commissioner. Registration information must minimally include: the name and business address of provider; the names and duties of officers, directors, trustees, partners, or managers if the provider is a partnership, corporation, or association; name and business address of person's with an ownership interest in excess of 5% in the provider or manager of the home; description of the provider's business experience; statement as to whether provider or any of its officers, directors, trustees, partners, or managers, within ten years prior to the initial registration, was a party to any civil, criminal, or administrative actions specified in the statute (including bankruptcy proceedings); identity of other homes currently or previously managed by the provider or manager of the home; provider's affiliations with any religious, charitable, or nonprofit organizations; a description of services to be provided; a description of the terms and conditions under which the agreements may be cancelled or fees refunded; a financial statement of the provider that has been certified by an independent certified or public accountant; a statement of the anticipated source and application of funds to be used in the future purchase or construction of the home; copies of the continuing care agreements to be used by providers; a statement of the location and description of the properties, both existing and proposed, in which the provider owns a 25% ownership interest (§ 23-2-4-4).

2. Requirement that provider must file an annual financial disclosure statement with the State Securities Commissioner which shall minimally include an income statement for the last fiscal year and a balance sheet as of the end of the provider's last fiscal year (§ 23-2-4-5).

3. Statement as to the duration of registration and the conditions under which registration may be revoked (§ 23-2-4-8).

4. Requirement that provider establish an escrow account for entrance fees, or post a letter of credit, negotiable securities, or a surety bond with Securities Commissioner (§§ 23-2-4-10, 23-2-4-11).

5. Statement restricting the use of entrance fees only for purposes directly related to the construction, maintenance, or operation of the particular home for which the fees were received (§ 23-2-4-12).

6. Establishment and operation of the Indiana Retirement Home Guaranty Fund to provide a mechanism for protecting financial interests of residents and contracting parties in the event of the bankruptcy of the continuing care provider (§§ 23-2-4-13 thru 23-2-4-19).

7. Statement of the liability of providers to contracting parties (§ 23-2-4-20).

8. Availability to the State of Indiana of an injunctive relief remedy in the form of cease and desist orders (§ 23-2-4-23).

CRS-19

MARYLAND - Annot. Code of Maryland, Article 70B, § 7 et seq. ("Continuing Care Contracts"; effective July 1, 1980)

A. Responsible governmental agency: Maryland State Office of Aging

B. Services included in the definition of "life care," "continuing care," or "care": shelter and either medical and nursing services or other health related benefits (§ 7(B)).

C. Definition of term "life care contract," "continuing care contract," or analogous terms: a written agreement that requires a transfer of assets or an entrance fee, notwithstanding periodic charges, to an individual 60 years of age or older not related by blood or marriage to the provider for the life of the individual or for a period in excess of one year, in exchange for the furnishing of shelter and either medical and nursing services or other health-related benefits (§ 7(b)).

D. Major statutory provisions:

1. Requirement that continuing care providers must apply for a certificate of registration for each facility with the Office of Aging. Applications shall contain at least the following information: name and address of the provider, facility, and, if relevant, other statutorily specified persons or legal entities; copy of the corporate charter, partnership agreement, articles of association, membership agreement or trust agreement as it pertains to the legal organization of the applicant; a certified statement of the applicant's financial situation; a statement of provider's affiliations with any religious, charitable, or other non-profit organization; a statement of the provider's fee structure; a copy of the continuing care agreement to be entered into; description of the physical facility to be used in furnishing continuing care; samples of circulars or advertisements published or planned during the past 5 years; a statement of the role of any publicly funded benefit or insurance program in the financing of the care provided by the applicant (§ 10).

2. Requirement that provider file an annual application for a renewal certificate (§ 10(b)).

3. Prohibition against removal of records or assets related to the operation of a facility from the State of Maryland unless approved in writing by the Office of Aging (§ 12).

4. Statement of the types of provisions required to be included in a continuing care agreement (§ 13).

5. Statement of the circumstances and manner in which a continuing care agreement may be rescinded (§ 14).

6. Statement of the conditions under which a resident of a continuing care facility may be discharged from the facility (§ 15).

7. Statement of the authority of the Office of Aging to inspect and investigate continuing care facilities (§ 17).

8. Statement of the grounds and procedures for suspension or revocation of a certificate of registration (§ 22).

9. Requirement that providers who intend to offer continuing care contracts but who have not acquired the necessary facilities for providing continuing care must file with the Office of Aging a statement of intent to provide continuing care, including the same information required to be included in an application for certificate of registration (§ 11).

10. Requirement that all providers of continuing care must file a feasibility study with the Office of Aging, including information at least with regard to the purpose and need for the project and the reasons for the proposed construction, expansion or renovation; the financial resources of the provider; the capital expenditures necessary to accomplish the project; and the financial feasibility of the proposed project, which shall include future funding sources (§ 11).

11. Provision allowing providers to collect deposits form prospective members, provided that a feasibility study has been approved by the Office of Aging and that funds are maintained in an escrow account (§ 11).

12. Requirement that information provided to the Office of Aging by providers pursuant to this statute must be made available to all interested persons (§ 10(f)).

13. Liability, penalty, and equitable relief provisions (§§ 18, 19, 20).

CRS-21

MICHIGAN - Michigan Compiled Laws Annotated § 554.801 et seq. ("Living Care Disclosure Act"; effective July 1, 1977)

A. Responsible governmental agency: Michigan Department of Commerce, Corporation and Securities Bureau

B. Services included in the definition of "life care," "continuing care," or "care": shelter, food, clothing, medical attention, entertainment or other personal advantage or attention (§ 554.803(2)).

C. Definition of term "life care contract," "continuing care contract," or analogous terms: (a) life interest -- a life lease, life membership, life estate, or other similar agreement between a purchaser and a facility by which the purchaser pays a fee for the right to occupy a space in the facility; (b) long-term lease -- an agreement between a purchaser and a facility whereby the purchaser pays a fee for the right to occupy a space in the facility for at least one year but for less than the life of the purchaser (§ 554.803).

D. Major statutory provisions:

1. Statement that the statute applies to all written or oral agreements between a facility and a member in connection with the offer or sale of a life interest or a long-term lease (§ 554.805).

2. Prohibition against employment of fraudulent or deceitful methods in connection with the offer or sale of a life interest or long-term lease (§ 554.806).

3. Requirement that persons shall not offer to sell a life interest or long-term lease in the State of Michigan unless the facility is registered with the state. Applications for registration must minimally include: the name and address of the facility and the name and address of any affiliated parent or subsidiary company or partnership; a statement of the affiliations of the facility with any religious, charitable, or non-profit organization; the identity and experience of persons affiliated with the facility; financial information as specified in the statute; a statement of whether a person identified in the application has been a party to any of the statutorily delineated criminal, civil, or administrative offenses; a copy of a feasibility study unless waived by the bureau; a statement with regard to fees required of members; the location and description of the physical properties to be used in furnishing care; a statement of the services to be provided to members and the extent to which medical care will be provided; a statement describing the health and financial conditions required for a persons to remain a member of the facility; a copy of the membership agreement to be used; a statement of the terms under which an agreement is canceled and for which a refund will be due in the event of the death of a member; a statement of the terms under which an agreement can be cancelled within the first six months of residency and the basis for establishing the amount of refund due; a statement of the conditions under which a facility may relet a members room (§ 554.808).

4. Requirement that certain statutorily designated information must be included in the lease or membership agreement (§ 554.810).

5. Establishment of an arbitration procedure for the resolution of grievances between residents and continuing care providers (§ 554.811).

6. Requirement that each facility must appoint at least one resident (to be elected by the other residents) to the board of directors of the facility as an advisory member (§ 554.812).

7. Provision authorizing the facility to petiton a court to appoint an independent conservator or guardian in the event a resident becomes mentally or physically incapacited (§ 554.813).

8. Provision authorizing the state to exempt a provider from the registration requirements (§ 554.815).

9. Requirement that an applicant for registration shall file a pro forma financial plan with the Corporation and Securities Bureau (§ 554.816).

10. Provision authorizing the Corporation and Securities Bureau to require applicant to establish an escrow account, or at the option of the applicant, to furnish a surety bond, or guaranty, if it finds that such action is necessary and appropriate to protect prospective members from the unsound financial condition of a facility (§ 554.816).

11. Statement of the procedures and circumstances under which a registration may be revoked by the Bureau (§§ 554.817, 554.818).

12. Requirement that the purchaser of a life interest or a long-term lease subject to the statute's requirements, shall have 7 days to rescind the agreement without penalty (§ 554.819).

13. Requirement that registration must be renewed by an applicant on an annual basis, unless the Bureau specifies a different time period (§ 554.821).

14. Requirement that registrant must inform the Bureau in writing of any material change of information contained in the original application submitted for registration (§ 554.822).

15. Requirement that a registrant must file semiannual financial statements with the Bureau (§ 554.822).

16. Requirement that facilities shall keep and maintain accounts of their sales and proceeds (§ 554.823).

17. Provision authorizing the bureau to investigate the business affairs and to examine the accounts of a facility (§§ 554.823, 554.833).

18. Requirement that an applicant for registration shall file with the bureau an irrevocable consent form naming the bureau as its attorney to receive service of process in any noncriminal action arising under this statute (§ 554.825).

19. Provision authorizing the Bureau to require the filing and approval before use of any sales literature or advertising communication addressed or intended for distribution to prospective members (§ 554.826).

CRS-24

MINNESOTA - Minnesota Stats. Ann. § 80D.01 et seq. ("Continuing Care Facility Disclosure and Rehabilitation Act"; effective November 1, 1980)

A. Responsible governmental agency: Office of the County Recorder (of the county in which the facility is or will be located).

B. Services included in the definition of "life care," "continuing care," or "care": board, lodging, and nursing service, medical service or other health-related service, regardless of whether or not the lodging and service are provided at the same location (§80D.02).

C. Definition of term "life care contract," "continuing care contract," or analogous terms: a written agreement effective for the life of the individual or for a period in excess of one year, which is condition upon the payment of an entrance fee in excess of $100 and the payment of regular periodic charges for the receipt of continuing care (§ 80D.02).

D. Major statutory provisions:

1. Requirement that continuing care facilities must be registered with the office of the county recorder (§ 80D.03).

2. Requirement that the provider must deliver a disclosure statement to any person with whom a continuing contract is to be entered, or his representative, including information (to the extent that such information is not included in the contract for continuing care) with regard to: the identity and business experience of the provider; a statement of whether the provider is a partnership, corporation, or other type of legal entity; names of the officers, directors, trustees, partners of the provider, and that of any person having a financial interest in excess of 10% in the provider; a description of statutory specified legal matters (criminal, civil, or administrative) to which the provider was a party; statement of provider's affiliations with other nonprofit, religious, or charitable organizations; the location and description of existing or proposed physical property of the facility; a statement of the goods to be provided under the continuing care contracts; a description of the fees to be charged by the facility; a statement of the circumstances under which a contract may be canceled and the conditions under which entrance fees will be refunded; a statement of the health and financial condition required for a person to be accepted as and continue as a resident of the facility; pro forma income statements for the facility for a period of not less than five years; financial statements of the provider that have been audited by an independent certified public accountant; an estimate of the funds that are anticipated to be necessary to fund start-up losses; an estimate of the total amount of entrance fees to be received by residents; a statement of the anticipated source and application of funds to be

used in the future construction and purchase of the facility; a description of any mortgage loan or financing agreement intended to be used for financing the facility; a statement of the provisions that have been made by the provider to reserve funding or security to enable the provider to fully perform its obligations under continuing care contracts (§ 80D.04).

3. Requirement that a provider must establish an entrance fee escrow account and a reserve fund escrow account with a bank or trust company having its principal place of business in Minnesota (§§ 80D.05, 80D.06).

4. Requirement that provider file an annual financial disclosure statement with the county recorder of the county in which the facility is or will be located (§ 80D.09).

5. Provision establishing a formal judicial procedure for the rehabilitation or liquidation of a facility in the event of financial problems on the part of the provider (§ 80D.11).

6. Provision establishing a lien on the real and personal property of the provider or facility to secure the obligations of the provider under existing and future contracts; such lien is to be effective at the time the facility is first occupied by any resident and for the duration of a period of ten years (§ 80D.08).

7. Civil and criminal liability provisions (§§ 80D.13, 80D.16).

MISSOURI - Vernon's Missouri Stats. § 376.900 et seq. ("Life Care Contracts"; effective 1981)

A. Responsible governmental agency: Missouri Department of Consumer Affairs, Regulation, and Licensing, Division of Insurance

B. Services included in the definition of "life care," "continuing care," or "care": shelter, food, and nursing care, whether the care is provided in the facility or in another setting designated by the continuing care agreement, to an individual not related by consanguinity or affinity to the provider furnishing such care.

C. Definition of term "life care contract," "continuing care contract," or analogous terms: (a) life care - life lease, life membership, life estate, or similar agreement between a resident and a provider by which the resident pays a fee for the right to occupy a space in a designated facility and to receive continuing care for life; (b) care for a term of years - an agreement between a resident and a provider whereby the resident pays a fee for the right to occupy space in a designated facility, and to receive continuing care, for at least one year, but for less than the life of the resident.

D. Major statutory provisions:

1. Requirement that a life care provider must file an application for a certificate of authority for each facility with the Division of Insurance, including an annual statement in such form as the Division shall prescribe and including the following minimal information: the identity and background of the applicant(s); the terms and conditions of the life care contracts to be used, including the terms and conditions under which a life care contract may be canceled and the conditions under which any portion of the entrance fee will be refunded; a statement of fees to be charged; if the applicant is other than an individual, a statement of the applicant's financial interests in the facility; names of members of the board of directors, trustees, or managing partners if applicant is other than an individual; applicant's affiliation with religious, charitable, or non-profit organizations; the anticipated number of residents at the facility; provisions made by applicant to provide reserve funding or security to enable applicant to fully perform his or her obligations; information on parent company (if applicant is a subsidiary corporation); statements of any periodic rates to be initially paid by residents; anticipated sources and application of funds to be used for future purchase or construction, if construction or purchase of facility has not yet begun; terms and costs of any mortgage or financing agreements to be used for the financing of the facility; estimate of the total sum of entrance fees to be received from the residents; applicant's financial statements; an estimate of any funds which are anticipated to be necessary to fund start-up losses (§ 376.920).

2. Requirement that applicant furnish a copy of the application for a certificate of authority to all persons with whom a contract is being entered, at the time of or prior to the execution of the life care contract and each year thereafter upon request of the resident (§ 376.930).

3. Requirement that persons entering into life care contracts shall have seven days within which to rescind the contract without penalty or further obligations (§ 376.925).

4. Requirement that applicant establish an escrow account for entrance fees (§§ 376.940, 376.945).

5. Requirement that at least one member of the board of directors of a facility shall be a resident of the facility who is under a standard agreement offered by the provider (§ 376.950).

6. Prohibition against the transfer of a certificate of authority (§ 376.935).

CRS-28

OREGON - Oregon Revised Stats. §§91.690, 105.830, 105.835 (effective November 1, 1981)

A. Responsible governmental agency: (Not applicable)

B. Services included in the definition of "life care," "continuing care," and "care": food, shelter, medical care, or other personal services (§91.690 (2)).

C. Definition of term "life care contract," "continuing care contract," or analogous terms: (not applicable)

D. Major statutory provisions:

1. Requirement that the seller of any domiciliary accommodation or arrangement that entitles purchaser to continuing or life care must supply to prospective purchasers the most recent year end financial statement (§ 105.830(1)).

2. Requirement that seller must make available on the premises annually, a copy of the financial statement and give notice of the location of the statement to residents (§ 105.830(2)).

3. Statement of the liability of sellers and others for misrepresentations or for failure to provide financial statements to prospective purchasers (§105.835).

4. Requirement that a facility which requires a resident, as a condition of occupancy or use of the facility, to pay any sum, including a buy-in charge or down payment, prior to the first six months of occupancy, in addition to monthly payments, shall provide that the full buy-in charge or down payment less actual costs to the home must be refunded to the resident if for any reason the resident withdraws from the retirement facility within the first six months of occupancy (§91.690).

Cathy Gilmore
Legislative Attorney

ITEM 3. LETTER FROM SGT. JACK BISHOP, MOBILE, ALA., POLICE DEPARTMENT, TO SENATOR JOHN HEINZ, CONCERNING LIFE CARE FRAUD

Winston J. Orr
Chief of Police

51 Government Street
Mobile, Alabama 36602

Police Department

November 25, 1981

Senator John Heinz, Chairman
U. S. Senate Special Committee for Aging
United States Senate
Washington, D. C. 25010

Dear Senator Heinz:

Attached is the questionnaire relating to consumer problems and economic frauds against the elderly which you requested from Chief Orr for your committee's investigation. You have asked for personal-experience input into this project. It cannot get much more personal, as my own mother was involved in the swindle of the Alabama Meadows Retirement Village (see enclosed clippings) almost from the beginning.

The State of Alabama has taken the retirement settlement into receivership and is in the process of selling the settlement to a Dr. Kenneth Berg, who has defaulted on payments, yet still has control over the old folks living there. Yet these same old people, who have a vested interest in the settlement, do not have a voice in the operation of the settlement. When Dr. Berg became administrator, he drew up a new contract specifying numerous benefits. Shortly after the members (including my mother) signed the new contract, a letter was sent out by the State Conservator, Mr. Robert Denniston, cancelling various provisions of the contract.

My mother is so discouraged, she is losing spunk and her will to fight. The new so-called owners have caused her and others to experience out-and-out harassment. We have no place to turn for help. Neither the local District Attorney nor the State Attorney General will act on this matter. Our only recourse is to retain a private attorney, which will further add to the expenses. (My mother had already given her house to the Rev. Mr. Ballard for the so-called "lifetime" care.)

I would like to hear from you as we have a complete and up-to-date file that I will be more than glad to furnish your committee.

Yours very truly,

Sgt. Jack Bishop
Criminal Investigation Division
MOBILE POLICE DEPARTMENT

JB:m

ITEM 4. FEDERAL TRADE COMMISSION NEWS RELEASE AND CONSENT AGREEMENT CONCERNING CHRISTIAN SERVICES INTERNATIONAL (CSI) AND KENNETH P. BERG

FTC news

Federal Trade Commission *Washington, D.C. 20580*

FOR IMMEDIATE RELEASE: April 25, 1983

LIFE-CARE HOMES OPERATOR AGREES TO STOP MISREPRESENTING FINANCIAL RISK INVOLVED, UNDER FEDERAL TRADE COMMISSION SETTLEMENT

Christian Services International Inc., which has developed, marketed and/or managed approximately 200 life-care homes in 25 states, may not misrepresent to prospective residents the financial risk and the facility's financial stability, under a Federal Trade Commission proposed consent order announced today.

The homes guarantee lifetime living accommodations, meals and medical services for senior citizens, who must pay entrance fees, ranging from $15,000 to $100,000, and monthly service fees ranging from $250 to $500. Christian Services International (CSI) plans, promotes and manages the homes. Other persons or non-profit organizations, often set up by CSI's owner, Kenneth Berg, actually provide the facilities.

According to a complaint released with the consent agreement, CSI unfairly and deceptively implied in advertisements and promotional material that many of its homes are affiliated with religious organizations. In fact, while Berg himself is an ordained minister, CSI has no religious connection. Under the consent agreement, the company may not represent that any religious group is affiliated with its life-care homes or is legally or morally responsible for the homes' debts, unless that is the case. Also, CSI must provide prospective residents with a statement detailing any religious affiliation or explaining that there is none.

The complaint also charges CSI represented there is little or no financial risk in entering into a life-care contract. Under the agreement, the company may not make this claim. CSI must disclose to prospective residents that entering into the contract may involve significant financial risk, and they should seek independent advice before signing.

The company allegedly claimed large institutional lenders holding mortgages on its homes would ensure the facilities' financial stability and economic survival. In fact, the lenders have no obligation to ensure the homes' financial viability. Under the agreement, CSI may not make a similar claim unless it is true. Also, the company must provide a statement explaining that any mortgage or other financial claims against the facility have priority over residents' financial interests, if that is the case.

(More)

The FTC charged CSI claimed that if it raised service fees, the increases would never exceed corresponding increases in average Social Security benefits over the same period. However, the company has raised monthly service fees in excess of the Social Security amounts. The agreement prohibits CSI from making misrepresentations on this point. CSI also must tell prospective residents that service fees are subject to periodic increases, if that is the case.

The company allegedly represented that many of the persons or organizations providing the homes have established sizable reserve funds to protect residents' interests. In fact, reserve funds primarily protect the mortgagees' investment, not the residents' interests, and investors may later withdraw the funds. Under the agreement, CSI may not make false claims about reserve funding. Also, it must give prospective residents a statement describing any provisions for reserve funding, such as escrow accounts. The company must also disclose if there is no such provision.

In addition, CSI allegedly did not disclose the following to prospective residents:

- CSI receives substantial fees for architectural and construction services performed at the homes, while not affording independent contractors the opportunity to bid competitively.

- There is pending litigation against CSI that could affect its ability to fulfill contract obligations.

- There is an administrative order against CSI concerning its marketing practices.

- Prospective residents' deposits were spent immediately and therefore were not available for promised refunds.

- Money from entrance and service fees is sometimes used in transactions not directly related to the homes.

The agreement requires that prospective residents receive this information and all the required statements at least five days before signing the contract or transferring money to the home.

In addition, CSI must furnish each prospective resident with specified financial information including audited financial statements by an independent certified public accountant.

(More)

The complaint and consent agreement name both CSI and Kenneth Berg. Christian Services has headquarters in Stilwell, Kan.

The FTC's New York Regional Office investigated this case.

The consent agreement is scheduled to appear in the Federal Register on Thursday, April 28. It will be the subject of public comment for 60 days, until June 27, after which the Commission will decide whether to make it final.

Consent agreements are for settlement purposes only and do not constitute an admission by the company that it violated the law. When issued by the Commission on a final basis, a consent order carries the force of law with respect to future actions. Each violation of such an order may result in a civil penalty of up to $10,000.

Comments should be addressed to the Office of the Secretary, FTC, 6th Street and Pennsylvania Avenue N.W., Washington, D.C. 20580.

Copies of the agreement, the complaint and an analysis of the agreement are available from the FTC's Public Reference Branch, Room 130, same address; 202-523-3598; TTY 202-523-3638.

# # #

MEDIA CONTACT: Janet Bass, Office of Public Affairs, 202-523-1848

STAFF CONTACT: Henry R. Whitlock, New York Regional Office, 212-264-1250

(File No. 782 3081)

[CSI]

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of	
CHRISTIAN SERVICES INTERNATIONAL, INC., a corporation; and KENNETH P. BERG, individually and as an officer of said corporation.	FILE NO. 782 3081 AGREEMENT CONTAINING CONSENT ORDER TO CEASE AND DESIST

The Federal Trade Commission having initiated an investigation of certain acts and practices of Christian Services International, Inc., a corporation, and Kenneth P. Berg, individually and as an officer of said corporation, and it now appearing that Christian Services International, Inc., a corporation, and Kenneth P. Berg, individually and as an officer of said corporation, hereinafter sometimes referred to as proposed respondents, are willing to enter into an agreement containing an order to cease and desist from the use of the acts and practices being investigated.

IT IS HEREBY AGREED by and between Christian Services International, Inc., by its duly authorized officer, and Kenneth P. Berg, individually and as an officer of said corporation, and their attorney, and counsel for the Federal Trade Commission that:

1. Proposed respondent Christian Services International, Inc. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Missouri, with its offices and principal place of business located at 5809 W. 164th Street, Stilwell, Kansas 66085.

Proposed respondent Kenneth P. Berg is an officer of said corporation. He formulates, directs and controls the policies, acts and practices of said corporation and his address is the same as that of said corporation.

2. Proposed respondents admit all the jurisdictional facts set forth in the draft of complaint attached.

3. Proposed respondents waive:

(a) Any further procedural steps;

(b) The requirement that the Commission's decision contain a statement of findings of fact and conclusions of law;

(c) All rights to seek judicial review or otherwise to challenge or contest the validity of the order entered pursuant to this agreement; and

(d) Any claim under the Equal Access to Justice Act.

4. This agreement shall not become part of the public record of the proceeding unless and until it is accepted by the Commission. If this agreement is accepted by the Commission it, together with the draft of complaint contemplated thereby, will be placed on the public record for a period of sixty (60) days and information in respect thereto publicly released. The Commission thereafter may either withdraw its acceptance of this agreement and so notify the proposed respondents, in which event it will take such action as it may consider appropriate, or issue and serve its complaint (in such form as the circumstances may require) and decision, in disposition of the proceeding.

5. This agreement is for settlement purposes only and does not constitute an admission by proposed respondents that the law has been violated as alleged in the draft of complaint here attached.

6. This agreement contemplates that, if it is accepted by the Commission, and if such acceptance is not subsequently withdrawn by the Commission pursuant to the provisions of §2.34 of the Commission's Rules, the Commission may, without further notice to proposed respondents, (1) issue its complaint corresponding in form and substance with the draft of complaint here attached and its decision containing the following order to cease and desist in disposition of the proceeding and (2) make information public in respect thereto. When so entered, the order to cease and desist shall have the same force and effect and may be altered, modified or set aside in the same manner and within the same time provided by statute for other orders. The order shall become final upon service. Delivery by the U.S. Postal Service of the complaint and decision containing the agreed-to order to proposed respondents' address as stated in this agreement shall constitute service. Proposed respondents waive any right they may have to any other manner of service. The complaint may be used in construing the terms of the order, and no agreement, understanding, representation or interpretation not contained in the order or the agreement may be used to vary or contradict the terms of the order.

7. Proposed respondents have read the proposed complaint and order contemplated hereby. They understand that once the order has been issued, they will be required to file one or more compliance reports showing that they have fully complied with the order. Proposed respondents further understand that they may be liable for civil penalties in the amount provided by law for each violation of the order after it becomes final.

ORDER

For the purposes of this order, the following definitions shall apply:

1. "Business Day" shall mean any calendar day except Saturday, Sunday and the following business holidays: New Year's Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day and Christmas Day.

2. "Entrance Fee" shall mean money or other property transferred or promised to be transferred as consideration for one or more individuals becoming a resident or residents of a life care home pursuant to a life care contract. Such fee may be paid upon the initial entrance of a resident to a life care home or may be deferred.

3. "Life Care Contract" shall mean a contract between a resident and a provider to provide the resident, for the duration of such resident's life, living accommodations and related services in a life care home together with nursing care services, medical services and/or other health-related services, conditioned upon the transfer of an entrance fee to the provider, and which may be further conditioned upon the payment of periodic service fees.

4. "Life Care Home" shall mean the facility or facilities occupied, or planned to be occupied, by residents or prospective residents where a provider undertakes to provide living accommodations and services pursuant to a life care contract.

5. "Provider" shall mean the person, corporation, partnership, association or other legal entity which undertakes to provide residents with living accommodations and services pursuant to life care contracts.

6. "Resident" shall mean a person who has entered into a life care contract with a provider.

7. "Service Fee" shall mean a periodic fee in addition to the entrance fee charged to a resident by a provider pursuant to a life care contract.

For purposes of this order, all required disclosures shall be made in a clear and conspicuous manner.

I.

IT IS ORDERED that respondent Christian Services International, Inc. ("CSI"), a corporation, its successors and assigns, and its officers, and respondent Kenneth P. Berg, individually and as an officer of such corporation, and respondents' agents, representatives and employees, directly or through any corporation, subsidiary, division or any other device, in connection with the advertising, offering for sale, or sale of any life care contract, in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

1. Representing, directly or by implication, that any religious denomination, organization or group is affiliated with a provider of any life care home marketed by respondents, or is legally or morally responsible for the debts and commitments of any provider of a life care home marketed by respondents, unless such is the fact.

2. Representing, directly or by implication, that there is little or no financial risk involved in entering into a life care contract marketed by respondents.

3. Representing, directly or by implication, that any lender which holds a mortgage on a life care home marketed by respondents ensures the economic survival of the life care home covered by the mortgage, unless such is the fact.

4. Representing, directly or by implication, that service fees at life care homes marketed by respondents will never be increased, or that service fee increases will never exceed corresponding increases in Social Security benefits over equivalent periods of time, or that service fee increases will be limited by any other objective criteria, unless such is the fact.

5. Representing, directly or by implication, that any provider of a life care home marketed by respondents has established reserve funding which ensures financial ability to perform obligations to residents under its life care contract, unless such is the fact.

6. Failing to furnish each prospective resident, at least five business days prior to the execution of a life care contract, or at least five business days prior to the transfer of any money or other property to a provider by or on behalf of a

prospective resident, whichever shall first occur, a disclosure statement which contains the following disclosures:

(a) A statement explaining any affiliation which the provider of the life care home marketed by respondents has with any religious denomination, organization or group, and the extent to which the affiliated religious denomination, organization or group will be responsible for the financial or contractual obligations of the provider; or, where no such affiliation exists, a statement that there is no affiliation with any religious denomination, organization or group.

(b) A statement that entering into a life care contract may involve significant financial risk, and that the prospective resident, before entering into the life care contract, should seek advice from an attorney, banker or other financial adviser who is independent of respondents and the provider.

(c) A statement explaining that a resident's interest provided by the life care contract is subject and subordinate to any mortgages on the life care home, or the interests of other creditors occupying a preferred status, if such is the fact.

(d) A statement that service fees are subject to periodic increases, if such is the fact.

(e) A statement describing the provisions that have been made, if any, to provide reserve funding or security as an aid to the provider in the performance of its obligations under life care contracts, including, but not limited to, the establishment of escrow accounts, trusts, or reserve funds; and whether, and under what circumstances, such reserve funding or security may be waived or reduced by the provider, the mortgagee, or other parties; or, where no provision for reserve funding or security has been made, a statement that such does not exist.

(f) A statement listing all fees to which respondents or the operating divisions, subsidiaries or affiliates of the corporate respondent are or will be entitled to be paid pursuant to contract or contracts with the provider including, but not limited to, fees for consulting, architectural, construction supervisory, marketing and management services. Such statement shall describe the nature of the services rendered or to be rendered, the fee rates or percentages, and the

trade names under which respondents perform such services.

(g) A statement listing the names and addresses of all professional services, firms, associations, trusts, partnerships or corporations in which respondents have, or which have in respondents, a ten percent or greater interest and which provide, or intend to provide, goods, leases or services to the provider of a value of $500 or more within any year, and a description of the goods, leases or services and the cost or probable or anticipated cost thereof to the provider, or a statement that such cost cannot presently be estimated, if such is the fact.

(h) A statement describing any currently effective injunctive or restrictive order of a court of record, or any federal or state administrative order, to which respondents and/or the provider are subject, relating to the marketing, management or operation of, without limitation, a life care home, retirement home, home for the aged, nursing home or foster care facility. The statement shall set forth the date and nature of the order and identify the court or authority which issued it. The statement required herein need not include orders which do not materially affect the financial condition of the life care home being marketed, or affect respondents' ability to market, manage or operate said home.

(i) A statement describing briefly the material facts with respect to pending litigation to which respondents and/or the provider are a party, and any outstanding but unsatisfied judgments against respondents and/or the provider, involving the marketing, management or operation of any life care home. The statement required herein need not include disclosure of litigation or claims which, if adversely determined, would cause no material adverse change in the properties or financial condition of the life care home being marketed, or would cause no material adverse change in respondents' ability to market, manage or operate said home.

(j) A statement as to whether advance payments made by prospective residents as all or a portion of their entrance fees are set aside in escrow accounts with banks, trust companies or other escrow agents.

(k) A statement disclosing that revenues derived from entrance fees or service fees have been, or are

intended to be, used in connection with ventures not directly related to the specific life care home in which the prospective purchaser may reside, if revenues are so used. The statement shall list the total amount of expenditures made or planned to be made in connection with such ventures.

7. Failing to furnish each prospective resident, at the time the disclosure statement required by Paragraph 6 is furnished, at least the following financial information:

(a) An audited financial statement of the provider prepared by an independent certified public accountant, including a balance sheet as of the end of the most recent fiscal year and income statements for the three most recent fiscal years or such shorter period of time as the provider shall have been in existence. If the provider's fiscal year ended more than ninety (90) days prior to the contract date or date of transfer of money or other property, and audited financial statements for that fiscal year are not yet available, interim financial statements shall be included, but need not be certified.

(b) A development budget for any life care home in a planning, development or expansion stage. The budget shall consist of a statement of the anticipated source and application of the funds used or to be used in the purchase or construction of any facility or building which is planned or under development.

(c) Pro forma financial statements which shall include pro forma annual income statements and balance sheets of the provider for a period of not less than five fiscal years. The pro forma annual income statements shall include:

(i) A beginning cash balance consistent with the certified income statement required by subsection (a) of this paragraph or, if operations at the life care home have not commenced, consistent with the statement of anticipated source and application of funds required by subsection (b);

(ii) Anticipated earnings on cash reserves, if any.

(iii) Estimates of net receipts from entrance fees, other than entrance fees included in the state-

ment of source and application of funds required by subsection (b), less estimated entrance fee refunds, if any. A description of the actuarial basis and method of calculation for the projection of entrance fee receipts shall be included.

(iv) An estimate of gifts or bequests if any are to be relied on to meet operating expenses.

(v) A projection of estimated income from fees and charges other than entrance fees, showing individual rates presently anticipated to be charged and including a description of the assumptions used for calculating the estimated occupancy rate of the life care home and the effect on the income of the life care home of government subsidies for health care services, if any, to be provided pursuant to the life care contracts.

(vi) A projection of estimated operating expenses of the provider of the life care home, including a description of the assumptions used in calculating the expenses, and separate allowances, if any, for the replacement of equipment and furnishings and anticipated major structural repairs or additions.

(vii) An estimate of annual payments of principal and interest required by any mortgage loan or other long-term financing.

In the treatment of entrance fees which are included in any of the financial statements required by this Paragraph an accounting method must be utilized which conforms to generally accepted accounting principles and which appropriately matches revenues to expenditures.

II.

IT IS FURTHER ORDERED:

(a) That respondents deliver, by certified mail or in person, a copy of this order to all of their present or future salesmen and other employees who sell or, through personal contact or telephone communication with prospective residents, promote the sale of life care contracts, and to any advertising agency utilized by respondents.

(b) That respondents provide a form to each of the persons referred to in subparagraph (a) of this

paragraph, to be returned to respondents, clearly affirming the intention of that person to be bound by and to conform his practices with the requirements of this order;

(c) That respondents inform in writing each of the persons in their employ referred to in subparagraph (a) of this paragraph that respondents are required by this order not to use, and shall not use, any such person to sell or to promote the sale of life care contracts unless that person complies with the provisions of this order.

III.

IT IS FURTHER ORDERED that the individual respondent named herein promptly notify the Commission of the discontinuance of his present business or employment relating to the marketing, management or operation of, without limitation, a life care home, retirement home, home for the aged, nursing home or foster care facility. In addition, for a period of ten (10) years from the date of service of this order, the respondent shall promptly notify the Commission of each affiliation with any new business or employment relating to the marketing, management or operation of a life care home, retirement home, home for the aged, nursing home or foster care facility. Each such notice shall include the respondent's new business address and a statement of the nature of the aforesaid business or employment in which the respondent is newly engaged as well as a description of respondent's duties and responsibilities in connection with the aforesaid business or employment. The expiration of the notice provision of this paragraph shall not affect any other obligation arising under this order.

IV.

IT IS FURTHER ORDERED that respondents notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of the order.

V.

IT IS FURTHER ORDERED that the respondent corporation shall forthwith distribute a copy of this order to each of its operating divisions and subsidiaries.

VI.

IT IS FURTHER ORDERED that the respondents herein shall within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

Signed this 1st day of March, 1983.

CHRISTIAN SERVICES INTERNATIONAL, INC., corporation

By: Kenneth P. Berg
Dr. Kenneth P. Berg, President
5809 West 164th Street
Stilwell, Kansas 66085

Kenneth P. Berg
Kenneth P. Berg, individually and as an officer of said corporation.

A. Glenn Sowders, Jr.
A. Glenn Sowders, Jr., Attorney
for Proposed Respondents

Henry R. Whitlock
Henry R. Whitlock, Counsel
for the Federal Trade Commission

Dennis J. Saffran, Counsel
for the Federal Trade Commission

APPROVED:

Leroy C. Richie
Leroy C. Richie
Regional Director
New York Regional Office

Roger Paszamant, Counsel
for the Federal Trade Commission

ITEM 5. CSI ADVERTISEMENT

FRIENDSHIP MANOR
Rock Island, Illinois

HARVARD VILLAGE
Harvard, Illinois

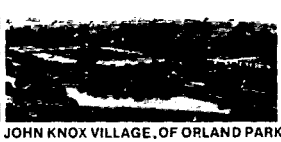
JOHN KNOX VILLAGE OF CENTRAL FLORIDA
Orange City, Florida

JOHN KNOX VILLAGE EAST
Higginsville, Missouri

JOHN KNOX VILLAGE OF FLORIDA
Pompano Beach, Florida

JOHN KNOX VILLAGE OF MARGATE
Margate, Florida

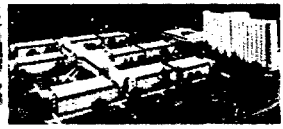
JOHN KNOX VILLAGE OF THE METROPLEX
Denton, Texas



JOHN KNOX VILLAGE OF ORLAND PARK
Orland Park, Illinois

JOHN KNOX VILLAGE OF THE OZARKS
Waynesville, Missouri

JOHN KNOX VILLAGE OF THE RIO GRANDE VALLEY
Weslaco, Texas



JOHN KNOX VILLAGE OF TAMPA BAY
Tampa Bay, Florida

JOHN KNOX VILLAGE OF WEST TEXAS
Lubbock, Texas

NORTHFIELD VILLA
Gering, Nebraska

SKYLINE VILLA
Omaha, Nebraska

TOWN AND COUNTRY VILLAGE
Perry, Iowa

TREZEVANT MANOR
Memphis, Tennessee

WESTMINSTER MANOR
Austin, Texas

CSI®

CSI RETIREMENT SERVICES
Kansas City, Missouri

CSI 269 790

ITEM 6. NEWSPAPER ADVERTISEMENT OFFERING "A HIGH PAYING SHORT TERM INVESTMENT"

17% Interest Per Annum 17% Interest Per Annum

A High Paying Short Term Investment

Dr. Kenneth Berg Expects to Assist In Building 800 Life-Long Retirement Centers Throughout the Nation to Help House the 80 Million Elderly Within 10 years

These Centers Are to be Built In Medium to Small Country Communities

These promissory notes are short term seed money investments, but very rewarding to the person who wishes to diversify these investments with maximum return.

Dr. Kenneth Berg
Has Developed More Successful Retirement Communities Than Anyone in the Nation

For Information Write:
DR. KENNETH P. BERG
P.O. Box 4045
Omaha, Nebraska 68104

ITEM 7. LIFE CARE CONTRACT BETWEEN DR. KENNETH BERG AND JOSE AND WILMA GARIBAY

~~LIFE CARE~~ Long Life RETIREMENT RESIDENCE—CONFIDENT

Name Jose & Wilma Garibay J. Spouse's Name ______

Street 4201 Fellowship Drive Telephone 661-1550 Date 3/19/80

City, State Mobile, Ala Zip 36619 Unit No. 205

	PLACE OF BIRTH—CITY & STATE (COUNTRY)	DATE OF BIRTH	SOCIAL SECURITY OR MEDICARE NO.
Husband	Jose Garibay	8/25/09	none
Wife	Wilma Garibay	1/21/09	none

Closest Living Relative

Arthur Day, 522 - Heflett Lane, Spring, Tex.

Rick Garibay, APO (Co Club Estates) [illegible] 6952

Personal References

661-2521 Nila Lane, 1st Floor Studios - [illegible]

Church Baptist Pastor [illegible] Doctor Charles Walsh

FINANCIAL DATA

ASSETS		LIABILITIES	
Value of Real Estate	$ Life Care Apt.	Real Estate Mortgaged	$ ~~Life Care~~
Investments	$ 3-7 thousand Cert.	Other	$
Savings Accounts	$ 7,000.00	Other	$
Other	$	TOTAL LIABILITIES	$
TOTAL ASSETS	$ 37,000	NET WORTH	$

MONTHLY INCOME

	1st Person	2nd Person		1st Person	2nd Person
From Social Security	$ None		Other	$	
Pension or Retirement	$		Total Monthly	$	

Your Bank American National - First National.

10% Down Payment Paid Paid apt in full Balance Due ______ Date ______

Chronic Illness or Disability Heart Disease. Thrombosis. Mr Excellent

Condition of Sight Glasses — (both) Hearing O.K. (both)

OTHER SPECIAL CONDITIONS OF THIS APPLICATION

Jose and Wilma Garibay ~~endorse~~ hereby Indorses without recourse the payment to Christian Services, Inc. (CSI) three 7 thousand Certificates of Deposit plus interest accrued to date, and also $40,000 in Alabama Meadows Bonds (Value unknown) due to the insolvency of the former Alabama Meadows, said Alabama Meadows now having been purchased and contract for sale of same by CSI from Corporation appointed by the Court. Owner, Christian Services, Inc. now hereby also unconditionally agrees in consideration thereof to assure that Jose and Wilma Garibay will have to make no further monthly payments of any kind or of any sort whatsoever, and not be subject to any monthly fee thereafter to CSI or its successors. [illegible] of the Meadows, Garibays will also receive [illegible] per month starting 4/1/80, and this amount will be reviewed annually and adjusted according to CSI, as long as either or both of the Garibays shall live at the Meadows, 4201 Fellowship Drive, Mobile, Ala, or its affiliates. Garibays shall have the unconditional rights, however, if physically able, to reside in the apartment they will live in, Apt 205.

I HEREBY DECLARE THAT ALL STATEMENTS MADE HEREIN ARE TRUE AND COMPLETE ACCORDING TO MY BEST KNOWLEDGE AND BELIEF.

IN WITNESS WHEREOF I HAVE HEREUNTO SET MY HAND TO THIS APPLICATION

THIS 20th DAY OF March 1980

Applicant X Jose Garibay

ATTEST [signature] Executive Administrator

Applicant X Wilma J. Garibay

ESI Copy.

BY Dr Kenneth Paul Berg

ATTEST X Dr Kenneth P. Berg

VILLAGE for Christian Services Inc.

ITEM 8. FINANCIAL BALANCE SHEET PURPORTING TO REPRESENT ASSETS OF KENNETH P. BERG

DR. KENNETH P. B
BALANCE SHEET
August 10, 1981

ASSETS	Fair Value
Residence and 10 acres of wooded lots - (already platted) - 604 S. Murray, Lee's Summit, Missouri	$500,000
Luxury residence - 510 N. Pryor Road Lee's Summit, Missouri	$336,000
Belton, Missouri property - 21 acres - 1101 Cambridge - zoned multi-family	$ 60,000
Five (5) lots zoned for 56-bed nursing home (including approved plans and permits) - Belton, Missouri	$ 50,000
119 acres adjacent to John Knox Village, Lee's Summit, Missouri	$357,000
Second Mortgage receivable - John Knox Village, Lee's Summit, Missouri	$750,000
Iowa Village South - investment in purchase agreement	$463,000
Cash on hand and in banks	$214,000
Investment in Iowa Valley West, Ferry, Iowa	$709,000
Receivable - Baker-Watts of Baltimore, Maryland - Sale of contracts	$660,000
John Knox Village of Rio Grande Valley, Weslaco, Texas	$12,500,000
Margate Retirement Residence, Margate, Florida	$850,000
Investors Mutual Funds	$ 25,000
Treasury Bills	$ 34,000
Autos and airplanes	$ 72,000
Furniture and fixtures (office & residences)	$ 25,000
Residence - 1616 New Orleans, Lee's Summit, Missouri	$112,000
Residence - Orange City, Florida	$ 62,000
Total	$17,779,000

This is a certified true copy of the original
VALLEY NATIONAL BANK
By

Liabilities - short term	
Vendors & trade accounts	$375,000
Long term debt	
Mortgages - 1616 New Orleans	$ 55,000
Due to banks - otherwise secured	$125,000
Mortgage - 3 properties - due Centennial State Bank	$300,000
Mortgage - Margate	$ 59,000
Mortgage - JKV Rio Grande Northwestern National - Minneapolis	$3,987,000
Total	$4,901,000
Net Worth	$12,878,000
Total	$17,779,000

Prepared by in-house auditor Glenn Saunders, C.P.A., and, any changes of a substantial nature will be made known to the court.

Dr. Kenneth P. Bell