Nonforfeiture:

Fairness in Change

Typically Continuing Care Contracts are for life and many, perhaps most, require the payment of an Entrance Fee upon acceptance into residency. Continuing Care Contracts are issued in conjunction with Continuing Care Retirement Communities (CCRC) or Continuing Care At Home (CCAH) contracts. In what follows the use of CCRC generally includes CCAH since the CCRC residential model is now dominant.

The word "nonforfeiture" ought not to intimidate. It is taken from practice in the life insurance industry. CCRC residents now generally forfeit all or part of their Entrance Fee if their circumstances change requiring them to forego the future commitments which the CCRC provider has made to them. Nonforfeiture would simply introduce a fair and equitable administration of these situations. Under contract law it cannot apply to existing contracts so only future residents would be affected unless an enlightened provider were to voluntarily adopt a fairer standard for contract termination.

The Entrance Fee can be a substantial investment for a resident and the loss of all or part of that investment can be devastating for a resident's financial well-being. The implication is that the Entrance Fee will be used ratably over the life of the contract to fund the promised benefits, but that expectation can be disrupted if a resident's circumstances change before death, ending the resident's ability to benefit from the contract.

In a charitable context, in which indigent residents were supported by charitable donations, it may have been reasonable to expect residents to forfeit all future interest in the charitable benefits provided. But that is different in a market based context, in which the resident is paying the full cost to provide the benefits. Since continuing care contracts are written by the providers without resident input, this change in the dynamic of the CCRC industry has not been recognized in the contracts offered.

Residents with declining balance refund contracts whose circumstances change leading to their leaving the CCRC, are forced by contract to give to the provider – the provider who drafted the contract that had to be accepted without change or modification – the full unexpended value of future services which the provider otherwise committed to provide.

And residents, who have a refund contract dependent on a successor resident, have an even worse situation. With most of today's refund contracts the marketing department has to convince a future resident to pay the predecessor's refund giving no benefit to the entering resident other than the vague possibility that a resident even farther into the future might conceivably agree to pay an Entrance Fee to continue the cascade of rolling refunds with each successor paying the refund for the predecessor.

How likely would it be that people would agree to such a diversion of their Entrance Fees to a predecessor if people entering CCRCs fully understood what they were getting themselves into? Not very likely.

Either approach allows the provider to recognize unearned income. The forfeitures with the declining balance refund contract, often called the standard

contract by industry sources, are not earned and can be used by the provider to fund ventures, to support underpricing, or to pay higher staff and executive incomes than otherwise.

Consider three examples of how such forfeitures now arise.   Both are true life cases.

1. A man and his wife move into a CCRC and continue to own a home nearby. Throughout their residency the wife is more content with the communal life of the CCRC than is the husband. After seven years residency, with the Entrance Fee now fully forfeitable, the husband decides that they can no longer afford both residences and he wants to live in the nearby home. To preserve their union the wife moves with him and the couple forfeits all interest in the CCRC. Some few months later the husband dies unexpectedly and the wife asks about returning to the CCRC. She is told that she would have to pay a second Entrance Fee.

2. In a second case a woman with a highly desirable apartment, well past the declining balance refund period, shows clear signs of mild cognitive disorder and incontinence. It is decided that she can no longer live in independent living. Since the facility has no dementia care unit, she is moved elsewhere. Due to HIPAA privacy restrictions other CCRC residents are not told of her impending move and she simply disappears from

one day to the next. The apartment is quickly resold for a fresh Entrance Fee.

3. After 18 years of living in a CCRC a 90 year old woman becomes alarmed by the level that her monthly charges have reached. Increases that may have seemed modest from the provider perspective have doubled her monthly fees. She is afraid that she may outlive her assets and just become an object of charity. So she decides to leave the CCRC and move to a condominium nearby. She misses her friends and the communal life but her living cost is now manageable. The remaining value from her Entrance Fee, now that she is entering that stage of life when she would be most likely to benefit from the care services included, is fully forfeited to the provider organization.

The booking of unearned income with the typical refund contract is even more insidious. There the industry, through the American Institute of Certified Public Accountants, has argued that it should be allowed to recognize as income funds that would otherwise be committed to meet the refund liability since "… the CCRC's own funds will never be used to make the refunds to the prior resident; instead, the CCRC is effectively facilitating the transfer of cash between the successor resident and the prior resident."[1] Clearly, it is disingenuous to use the

[1] http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175823803805&blobheader=application/pdf accessed on March 29, 2013.

promise of such a contingent refund as an inducement for residents to pay an elevated Entrance Fee.

The ideal situation would be actuarially neutral so that neither party would either gain or lose from a change in the relationship. This is the standard that was adopted for the life insurance industry and is the basis for the cash values found in life insurance contracts, which allow a policyholder whose circumstances change to cancel the insurance and to recover an equitable share in the value of the policy. This was not always the case for life insurance which led to revelations of executive excesses and behaviors in that industry.[2] The result was a call for reform and the introduction of a sound life insurance regulatory structure.

CCRC providers maintain that they need the unearned income from forfeitures, whether from the "standard" contract or implicitly from the contingent refund contracts, to keep CCRC living affordable. The implication is that CCRC pricing is itself actuarially neutral so that unearned income from forfeiting residents, or from the amortization of refund commitments into income, is used to reduce the cost for those residents who continue for life and who do not thus suffer forfeiture. It's likely that some few CCRCs do follow such sophisticated actuarial guidance in their pricing but many, perhaps most, CCRCs do not employ actuaries and simply rely on the accounting guidance cited above.

Thus, the CCRC industry today is where the life insurance industry was in those free and easy unregulated years before the need for reforms became evident. It then was clear to legislators and the public that there was a need for protections

[2] See http://www.harvardcasesolutions.com/2451-The_Armstrong_Investigation.html or http://books.google.com/books/about/Testimony.html?id=A08zAQAAMAAJ both accessed on March 29, 2013.

to shield a trusting public, lured by sophisticated sales practices into buying life insurance contracts that were often imperfectly understood, from the resulting corporate predations.

The Nonforfeiture proposal which accompanies this article is modeled on the life and annuity insurance precedent. It extends to CCRC residents and CCAH contractholders protections similar to those which have long shielded life insurance policyholders from exploitation by corporate interests. Of course, the corporate officers may not themselves be aware that their behavior can be seen as exploitative. They may merely believe that they are following established industry practice and they may sincerely see themselves as entitled to the forfeitures to which they fall heir.

But a fair balance of interests between providers – who have access to the most sophisticated and expert advisors – and residents – who are asked to accept the Continuing Care Contracts offered by the provider without modification – calls for protections to ensure that those residents or CCAH contract holders whose circumstances change are not prey to exploitative forfeitures by providers whether by design or by lack of insight.

The Nonforfeiture proposal simply makes contract termination a financially neutral development for both the provider organization and the resident. The resident thus pays fully for all contractual commitments undertaken up to the time of termination, but is not required to subsidize unjustifiably either the provider organization or other residents. The provider, too, is fully compensated for the value of contractual commitments undertaken and fulfilled but does not

have the windfall gains that can result from unforeseen contract terminations and forfeitures.