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FUNDING LONG-TERM HEALTH CARE

Moderator: SHANE A. CHALKE
Speaker: PETER J. FERRARA*

MR. SHANE A. CHALKE: The Individual Life Insurance and Annuity Development Section is pleased to introduce our luncheon speaker, Peter J. Ferrara, a senior Fellow at the CATO Institute in Washington, D.C. He is also an associate professor at George Mason University Law School. He has previously worked at the Heritage Foundation, where he was the John M. Owen Distinguished Fellow in Political Economy. He has also served as senior staff member at the White House Office of Policy Development and as a special assistant at the Department of Housing and Urban Development. His primary focus was leading the Reagan Administration's policy development team on enterprise zones. He is the author of three books concerning social security which are all outstanding but generally have little familiarity with the insurance industry, surprisingly. These three are *Social Security, The Inherent Contradiction*, published in 1980. Some of you might not like the title but I do. *Social Security, Averting the Crisis* was published in 1982 and *Social Security, Prospects for Real Reform* was published in 1985. Peter Ferrara has also practiced law in New York and Washington D.C. He holds a J.D. from Harvard Law School and an A.B. from Harvard. Mr. Ferrara will speak to us on the subject of long-term care and I promise you it will be a rather iconoclastic viewpoint.

MR. PETER J. FERRARA: The only thing I want to demur from that is everything I am going to say here is mainstream, middle of the road, and I can validate that. Well here we are in the Big Apple. Notice how some of these different cities have these nicknames. New York is the Big Apple, Philadelphia is the City of Brotherly Love, Chicago is the Windy City. I was in New Orleans a couple of times and does anybody know what they told me was the nickname of New Orleans? Well, what they told me was that New Orleans is the City of Sincere Lust. I just never had a chance to really validate that, but that is what they told me. Actually New Orleans I want to say is really one of my very favorite cities, it is one of the most interesting cities in the entire country, so, I hope you get a chance to go there.

Did you ever notice how in some of those dictatorships, some of those communist countries in particular, they have these talks for three hours? On the news they will say, "Chairman Fidel addressed an enthusiastic crowd in El Fidel square for three hours." I don't know how they kept that crowd enthusiastic for three hours; I think they pay them in those countries to come. And it is true, you watch the news -- Gorbachev sometimes speaks to the Politburo for three hours, and the Chinese leaders do also. In North Korea the speech can go on for three days. Yet it is part of the differences between sort of the western world and these other countries. And of course there are some other clear differences. You have heard about the difference between West Germany and East Germany. You see in West Germany you are always looking for a good party, in East Germany the party always finds you. Actually I should be telling my actuary jokes. I really want to be courageous here. They asked three professionals, an actuary, an economist and a lawyer, how much is $2 + 2$? And the actuary said it is 4. And the economist said it is somewhere between three and five. And the lawyer asked, how much do you want it to be? Notice that when people with southern accents talk about lawyers, lawyers comes out liars. They always say, "I hired the best liar in all Georgia."

Well the subject is long-term nursing home care so let's see what we can get out about that. What do we need to know to understand this topic because I am going to talk about it from a policy perspective. Well let me give you a basic important fact or situation. In general if you don't have the money to pay for necessary nursing home care in the United States, the government will pay for it under current law. That is a general principle. So when we are talking about policy, and

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where we should go and what programs we should adopt, we should recognize generally if you don't have the money for it, the government will pay for it. And the government already spends about \$20-\$25 billion a year on nursing home care primarily through Medicaid.

Now there are two basic loopholes in this system. One was recently plugged, the other is not entirely plugged. The real hardship used to be in the case of a married couple where one had to go into a nursing home. Under prior law, virtually all of the couple's savings had to be used for the nursing home care. Almost all of the income, except a very small amount, about \$350 per month, had to be used for the nursing home care. So the noninstitutionalized spouse was the one that was suffering the financial hardship in this situation. The government would pick up whatever they didn't have to pay for. But the noninstitutionalized spouse was left with so little income, no backup savings, \$350 a month; that was the real financial hardship. Now in 1987, this was changed and they are now phasing in a new system and under the new system, the noninstitutionalized spouse would be able to keep basically 150% of the poverty level income for a couple, which is about \$14,000. Now when this gets entirely phased in, in a few years, then the noninstitutionalized spouse will be able to keep for his/her own expenditures about \$14,000 a year, in today's terms. It will be adjusted annually. And in addition to that, the noninstitutionalized spouse will be able to keep \$12,000 in savings plus 50% of everything above \$12,000 until he saves up to \$60,000. The most they can retain on their own outside of the nursing home expenses would be \$60,000. The states can reduce that, if they want to be less generous, but most states do not seem to be reducing it. They can reduce it down to a minimum of \$12,000 in retained savings. So under this new system, that pretty much solves this loophole problem. There was a real financial hardship situation there before and now this new thing is being phased in. And that is mostly going to eliminate that loophole. So again if you don't have the money to pay for it, without great financial hardship, then the government will pay for it.

The second loophole is that in some states, if you are going to go into a nursing home at Medicaid's expense, but you could stay at home for less with home health care, then Medicaid will pay for the home health care and allow you to stay at home. But in some states this is not the law, and you can't get Medicaid to pay for the home health care, even if it does cost less. So this is another loophole in this general principle in my view. This could be changed so that the home health care would be available in every state.

Perhaps there are some other loopholes here and there, and if so they should be fixed up, but I don't think there are. In general I think that if you don't have the money to pay for this necessary nursing home care, the government will pay for it and in my view this is the proper government role and this is the extent of the proper government role. Once the government has provided for those who don't have the money to pay for the care, then what's the remaining issue? What is the question that remains? Well the issue remains for those who do have the money to pay for their care. At least for a while. And the concern here is that the life savings not be consumed by the high nursing home cost. The concern here is that someone who has worked all of their lives and saved \$50,000 or \$100,000 or \$150,000 or more, should not have all that wiped out in the last few years of life by nursing home costs. That is what the concern is that remains, once the government pays for all those who don't have the money to pay for their care.

Now what can we say about this issue? Well first, if this is the concern, we are not really talking here about a health policy issue at all. We are not talking about access to needed care, that is assured. If you can't pay for it, the government pays for it and if you can pay for it then you have the access. What we are talking about here is an estate planning issue -- how to preserve the substantial resources that a high proportion of the elderly do have. And in my view the preservation of substantial accumulated assets is not an activity for the government to get involved in with taxpayer funds. That can and should be done through the private sector. In fact, those who are in this situation can and should use part of their accumulated savings to purchase private insurance to protect the rest. You can't say that those with the substantial accumulated savings can't afford the insurance, or don't have the money for it. And this is the answer to those who say that you have to become impoverished to get assistance under any means-tested program. You don't have to become impoverished. You can buy insurance with part of your accumulated savings to protect the rest. So if the issue really is a matter of an estate planning issue, that clearly is something that the private sector deals with all the time. We are talking about people who do have resources and who can take steps to protect those resources. The government should not be taxing general taxpayers to preserve accumulated estates. Now let's say you sort of fall in the margin; perhaps you have modest savings, around \$10,000-15,000. That is your life savings

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and you feel that it just doesn't pay to buy insurance to protect it. The insurance premiums themselves over the years are going to consume that modest amount of savings. Now note, if a couple is in this situation, if this is their life savings, and one of them has to go into the nursing home, that savings is protected under this new provision that I was discussing. So the problem here really applies to single elderly people who go into nursing homes, which is 88% of the nursing home population. Only 12% of people in nursing homes have spouses. And so now we turn to a single elderly person with some modest funds. It seems to me in this case it is not too much to ask of those who do have some money that they contribute to their own care; to contribute the modest amount of \$10-\$15,000 before the taxpayers are asked to begin to cover the bills. Taxpayers are picking up a tab of \$25,000 per year for the rest of the person's life. If the person is able to make a modest contribution, it seems to me it is not too much to ask before the taxpayers are asked to bear the burden. This is particularly so since we are talking about a single elderly person who has no one else dependent on his savings and who is going to receive the necessities of daily life in the nursing home and who is very disabled and therefore has a lack of ability to really personally use those funds for much else than his needed care. So this analysis would indicate the basic scope of what I see as sound policy, in regard to long-term care. The government's role is to pay for those who don't have the money to pay for their care. For those who do have the money, the concern is how to preserve those funds. That is not a health policy issue, but an estate planning issue and the government does not have a valid role to use taxpayers funds to preserve private estates. That function can and should be done through the private sector, through private insurance and other sorts of means.

Well let's look at what would happen. Let's look at the problem with trying to go beyond this and provide an entitlement for everybody, for nursing home care and home health care. Let's say the government is going to do it regardless of how much money you have. What are the implications of that? Well such a program would be enormously costly. Total nursing home expenditures in the United States are about \$50 billion. Total home health expenditures are over \$10 billion. But that is just the beginning. Only 29% of those who need long-term care are in nursing homes. The remaining 71% are in the community receiving care from their families. If the government starts picking up the tab for all nursing home care, what is the implication of the fact that only 29% are in nursing homes and 71% are outside nursing homes? The law of supply and demand takes over. Many more people are going to enter the nursing home, increasing the program's cost. If 71% are outside nursing homes, and really receive very similar type of care, and really need this long-term care, there is a potential scope for increased utilization.

Now the problem for home health care is even worse. You have to understand that when we are talking about home health care, we are not really talking about medical care in the home. That is generally already covered. When people say they want to extend coverage for home health care, they are talking about assistance in the activities of daily living. Cooking, cleaning, bathing, dressing, eating, going to the bathroom, moving around, shopping. Let me give you this statistic in regard to home health care. Seven-four percent of the elderly who need such care currently receive it without charge from family and friends. So if 74% need this kind of home health care, they receive it voluntarily from family and friends. Twenty-one percent receive part from the family and friends and part from paid help; and only 5% receive such care entirely from paid help. Now what is the implication of this if the government starts offering free home health care? There will be a massive displacement problem. The family and friends who are providing all the care are going to start to wither away if the government is going to pay to provide the service, causing the cost to soar. Not only do you have a huge proportion of people getting it now for free, and you have a potential for displacement of that, but it is going to be particularly so because the volunteers find the care burdensome. They do want to help out their family members but it is difficult to perform these functions. Unlike nursing home care, the elderly and their families find the home health care services attractive. Some people don't want to go to nursing homes. Families are reticent about putting their parents into nursing homes. But in home health care, it is quite the opposite. The services are very attractive. Someone can come in and do the cooking and do the cleaning and perform these other functions of home health care. The elderly who can qualify for that service are going to want it. They are not going to want to go in nursing homes so much, but if they can qualify for home health care, they are all going to want to get it; their family members are going to want them to have it. Both because they feel they should have it and because it relieves the burden on the family members. What is going to happen is, the energy of the family members that formerly went into providing the care, will go into lobbying to get the government to provide the professional care to their parents. They are going to put all their effort into getting the government to provide this care. In fact, because the service is so

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attractive, you will have many elderly people who do not receive this kind of assistance trying to qualify for the government-financed assistance if the government is going to offer it as an entitlement. Because when you are an elderly person, it becomes subjective, more of a judgment call. Do you need this kind of service? Many people who are on the margin or who are functioning independently would like to have someone come into their house and help with the cooking, help with the cleaning and help with the shopping because it is a very attractive service. You are going to have this lobby effort and many of them are going to succeed.

In the late 1970s there was a series of General Accounting Office reports that said as many as 30% of the people receiving payments under the federal disability insurance program were not disabled. But yet they were continuing to receive those benefits. And the government has been unable to clean up that program because of the politics involved. You have a very difficult time telling someone they are not going to get payments anymore. They are going to call their congressman and their congressman is going to tell them that he is going to do a good job. The result is they have not really been very effective in trying to address that problem. In fact, to take this one step further, because you are dealing with a very attractive service, many family members who formerly provided the care will instead arrange to receive care and assistance when the government is paying the bill. When the home health aid is picking up groceries for the elderly person, the aid will often end up picking up groceries for the whole family. When the home health aid is doing the laundry for the elderly person, the aid will often end up doing the laundry for the whole family. When the home health aid is cleaning the home for the elderly person, the aid will often end up cleaning the home for the whole family. This is very natural to see when you have two elderly people living together; one qualifies for home health care and the other one may not. How are you going to draw the line in that family? In fact the pressures will be to expand the role of the government-provided care. It is going to happen when the elderly person is living with his adult children and their children. In fact, under Medicaid finance programs this goes on.

I did a big study in New York state over the summer. I interviewed a lot of people, it wasn't solely focused on this issue, but I talked to them about this among other things and they said this happens all the time. Maybe mother and father both work and grandmother is living with them. Over time the home health aid begins to take over more and more of the family responsibilities in that house for the entire family, at government expense. All these kinds of abuses are going to increase the cost even further of a government home health care entitlement program. And because home health care is so personal and is provided in the privacy of the home, controlling all of these abuses is going to be impossible. How are you going to keep track and monitor what the home health aid is doing in the home, what people are asking the home health aid to do? In the privacy of the home you are dealing with very personal treatment and care; the government and the bureaucracy are not going to have any way to control this. The proper government role in home health care is to pay for the care of those who would otherwise be in a nursing home at government expense and could be cared for at home at less expense, as suggested above. Otherwise home health care can and should be provided by family and friends as it is. And you should not displace this voluntary care. And we cannot control the abuses if we try to do so. It would be a very grave mistake in my judgment if we are going to pay for paid professional care to go in and take over the responsibilities of people who are now fulfilling those responsibilities voluntarily.

These are cost-increasing factors beyond the initial expenditures and there is one more that would apply. Whenever the government picks up the bills and pays for these costs you get a massive increase in the charges for those costs. A sharp increase in demand for nursing home and home health care will result from an entitlement program, and that is going to massively increase what is charged. You will see a price inflation in this area for nursing home and home health care. This same thing went on when the government started providing very large student loans in the mid-1970s. The price of higher education shot up. The more government puts into acute medical care, the more rapidly the prices go up. You can see this in many other areas. In fact I think if you look at the data you will see that the cost of nursing home care has risen at a slower rate than the cost of medical care for the elderly in general. The medical care for the elderly in general is covered by government programs and nursing home care, except in limited circumstances. I think the history of that indicates again, this is going to be a further problem that is going to increase the cost. Well if you add up all these factors, the cost of a universal entitlement program for nursing home and home health care will probably be around \$60-80 billion per year, in additional spending. Even some of the groups that are advocating this admit it will at least cost \$50-60 billion a year.

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Now what is the implication of this fact? It means taxes and therefore deficits. But under the current environment they are not going to allow the deficit to grow, because we have Gramm Rudman. In fact under current law you cannot propose a new program, because of Gramm Rudman, without proposing the funding for it. So you can't propose a new program in Congress without proposing the funding for it, and a program costs \$60-\$80 billion, that implies taxes which means that program isn't going to be adopted. We are not going to have this kind of entitlement program because there are no lambs out there who are going to be fleeced for \$60-\$80 billion a year. Who is going to pay for this? Whose taxes are they going to increase? We saw what just happened with the catastrophic health insurance surtax. That only raised 10% of the amount of revenues that was needed for this and we saw the enormous backlash. And they turned to that surtax because they felt they could not raise taxes on young workers and they could not raise taxes on the economy and business in general. So they tried to turn to the beneficiaries but the beneficiaries said they could not raise their taxes either. So I think if you look at what is going on now, this program that some people are talking about is not going to be passed. There is a commission in Congress that is studying this and there is going to be a report; although they are all squirming now, because of these precise implications. They are all squirming to try and figure out what they are going to propose. They will propose something in February or March that is going to get a lot of fanfare and people will talk about it a little bit, and you are not going to hear about it again after that. Particularly if they propose some financing. Because they are going to immediately be chopped alive by the people that they propose to gouge.

Now there will be an effort in Washington to underestimate the cost of the new program. That is how they got Medicare adopted. When they proposed Medicare they said in 1979 Medicare would cost \$9 billion for that year. That was their projection when they adopted it in 1965. In 1979 Medicare actually cost \$69 billion. So there is going to be some effort to squirm around. They can't even raise \$20 billion in new taxes for a program like this because they are not going to want to go out there and try this thing again. The easiest tax to get through should be one where benefits are given in return for a tax. How are they going to get a tax through now if they are going to say to someone, "Well you don't get the benefits, they get the benefits; but we have to impose this new tax on you." There are no real revenue sources for that kind of thing. Moreover it seems to be that adopting such a huge new entitlement program in the face of the pending retirement of the baby boom generation would be foolhardy. Medicare itself is projected to go into bankruptcy well before the baby boom generation retires. In addition there is really no rationale for such an expanded government role. The proper government role is to pay for those who can't pay for their care. An expanded entitlement program would probably end up being regressive: taxing those who have less resources, to preserve the resources of those who have more. The challenge is to fulfill that huge role so that sound public policy would not be undermined.

Well how can the private sector begin to approach this? What are some of the things the private sector can do? Well as many of you probably know, the long-term care insurance market is in its infancy but it has been started. Even as of a year or two ago, there were 70 companies offering long-term care policies covering about a half million of the elderly. That is a start, but if it is going to perform this function, it has got a long way to go. What can be done to promote the market or other private alternatives? Well we can use a clarification of the tax treatment of the reserves for long-term care policies to make sure that they are treated the same as for life insurance policies. Apparently the engines are moving on that in Washington and there may have in fact been something that occurred recently on that. The concern there being that you don't want to have the build-up on a long-term care policy taxed before the premiums have to be paid. Apply the same tax treatment to long-term care insurance policies as they apply to life insurance policies. Make expenses for long-term care and long-term care insurance, eligible for the medical expense deduction. Allow employers to offer retirement long-term care as part of cafeteria plans. Allow employer deductions to fund long-term care retirement insurance so that during working years employers can offer it as an employee benefit. Be sure it is going to allow them the deduction for the contributions' reserves. Allow employees the option to direct those vested pension benefits or IRAs or 401(K)s to purchase long-term care insurance. Also have a long-term care rider to life insurance policies. After retirement the death benefit begins to phase out and a long-term care benefit begins to phase in. Or there are some policies that are being offered which will provide \$100,000 in life insurance or long-term care benefits and the beneficiary can choose which one. And if they spend more on nursing home care then they get less in life insurance benefits. That serves as a sort of a control on the utilization because the person is going to have to give up one thing to get another. Another idea that has been advanced is that the pension

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annuity could provide for a doubling of income for any one chosen year. Retirees for one year of their own choosing, under this annuity, could double their income. Seventy-five percent of nursing home stays are for less than one year, so by doubling this annuity, substantial resources would begin to cover a typical nursing home stay. If the doubling was not used, it could go into the estate at the end of life. There is a questionable proposal now that calls for a federal reinsurance agency that would make a reinsurance market for long-term care policies. Actually this is a new proposal and it is worth looking into more. Then there are various things that can be done with home equity -- providing more resources for either purchasing long-term care insurance or paying the expenses directly. A reverse annuity mortgage is where the elderly homeowner would receive a payment each month in return for a mortgage that would grow on the person's home. Payments would grow as they are made and then the mortgage would be paid off when the house was sold. Or there could be a sale/leaseback arrangement where the elderly homeowner would sell the home to a financing institution with an unlimited right to rent back the property for life at a predetermined rate. Now over 60% of the elderly own their own homes free and clear, so there is a substantial amount of resources here, to direct to this kind of issue.

The elderly can also trade their current homes for residences in retirement care communities which are designed to provide long-term care inexpensively. Now currently most examples of that are very upscale and are not suitable for the majority of the population but as the elderly grow in numbers over the years, this may become something that some people might try to provide on a more modest basis; that is available to a higher percentage of the population. Now there is another proposal in Congress, which is really one of my favorites, which expands the whole approach to deal with Medicare as well as nursing home care and catastrophic health care. And that proposal is the Health Care Savings Accounts Bill. Representative D. French Slaughter, Jr. from Virginia has been the primary sponsor of this but it has been kicking around in Congress for four or five years. It has always had about 40 co-sponsors, including several Democrats and Republicans and even several liberal Democrats as well as conservative Republicans. A worker and his employer would contribute to a health care savings account up to certain limits, in return for a 60% income tax credit during his working years. To the extent that this option was exercised, the worker would then have a higher deductible under Medicare during retirement -- as high as a few thousand dollars per year. But then the funds that are in this health care savings account would be available to purchase insurance to cover the extra expenses or to pay them directly. This person is given a tax credit up front because he is going to get less Medicare at the end. So some of their money is put back in this private account. Then they can't use that money for anything else during working years. They have to save it for the retirement medical care and then when they reach retirement, if they have done it throughout their entire life, they may have an extra deductible of \$5 or \$6 thousand and they could then buy insurance or use the funds to pay those bills directly. They could choose how much of that they wanted to cover by insurance and how much they wanted to be directly responsible for. And the system is designed so that the retirees would likely have more than enough in these accounts when they reached retirement than is necessary. Those extra funds could be used for long-term care insurance. Also under the Bill if you spend less than a specified proportion of the funds in this account each year for insurance or health care, you can withdraw the difference and spend it on anything. So we have a formula in the bill and it takes a certain percentage of the account.

If you spend less than that percentage on insurance or medical care for that year, you can use the difference for anything. This bill is an incentive for people to start controlling the cost of rapidly rising medical care. If someone else is paying the bills, the concern for cost is eliminated. But if you can get a reward by worrying about cost, and shopping for the best deal and the lowest costing insurance, and maybe not overinsuring but taking a reasonable front-end deductible, you begin to create incentives. Hopefully the population will start to do this so there will be competition. The providers of products will then begin to recognize this new option and use it and encourage the population to utilize it. This should create a new competition in mechanisms to reduce cost. Or at least that is the idea behind the Bill.

Workers who exercise the options substantially over their careers would also receive extended catastrophic benefits under Medicare. So in return for taking that front-end responsibility, Medicare would then pick up the catastrophic benefits on the high end which actually on a relative basis don't add up to that much cost.

I am doing a study on this right now to calculate the ultimate impact of all this. There is a dramatic reduction in Medicare expenditures over the long run, if a high proportion of the elderly

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exercise this option. Potentially we are trying to see if the long-term Medicare financing crises can be avoided by having a great majority of the population enter this kind of system. Can we avoid a long-term financing problem without raising taxes or cutting benefits? The current projections are that quite possibly the tax rate that would be necessary to finance Medicare by the time young workers retire, would be as high or higher as the tax rate for all the rest of Social Security. Currently the tax rate is 2.9% for Medicare and approximately 12% for Social Security. The projections are it is quite possible that Medicare expenses alone would exceed what it currently is for Social Security. So this might offer an opportunity to begin to shift responsibility to private savings and insurance so that when that baby boom generation hits and that financing crisis hits there won't be such a burden on the government.

These are some of the ideas that people have talked about in Washington or that I and others have worked on. Now as my final question, what ideas or other things can be done to improve or enhance the long-term care insurance market? We are all in product development here. What else can be done as a matter of public policy to enhance the long-term care insurance market so we can perform this role? Along the lines of home equity conversions, what can be done to make those mechanisms I discussed more viable? What are the things that might be needed to enable the private sector to perform this role? I think a sound analysis ought to be done through the private sector. You are dealing with people with resources and the issue is how to conserve those resources and protect them. That seems to be a classic insurance or private financial market type of role.

Reverse insurance would be where the insurance company pays the premium during working years and then when the person dies the lump sum goes to the insurance company. That is a way of utilizing some of the resources people have without making them feel they have totally given up those resources. Although there would have to be some controls on what they could do with available resources or something during retirement years. That's one possibility. What can the government do to make long-term care insurance a more viable product? Or what is necessary to make long-term care insurance a bigger product, adopted by more of the elderly? Of course there is an issue here as some elderly people may just not want nursing home care insurance. That is one of the political issues here. There is some reticence among the elderly when you tell them that the government is going to pay for their nursing home care. A lot of them say they don't want to go into a nursing home. I am not excited about them paying for my care and some of them who are more foresighted will say in fact "if the government starts paying for nursing home care maybe it is more likely that I will end up in a nursing home." And so they begin to get a little more excited about home health care. But I think there is actually some political reticence out there and I think that is something that has to be recognized. If a person doesn't want to buy long-term care insurance, that is something that should be allowed. On the other hand, if the alternative is to have the government take over, then maybe there should be some kind of requirement. Are there any other suggestions of private sector products or government policies that could promote private sector products?

FROM THE FLOOR: Limit lawsuits against insurance companies.

MR. FERRARA: Lawsuits on claims and medical malpractice insurance are a high cost burden as a result. I think that is a problem in health care in general. That is one of the big factors in our rapidly rising health care situation. Whenever I see the debates on this issue, I never side with the lawyers. I just don't think that they have the best part of the argument. I think the problem we have had here is that there used to be a standard that said you were liable for malpractice if you were at fault and if you failed to comply with some standard. But more and more courts have just depreciated that standard so it becomes one of effective insurance. You insure a good result and if good results do not come out, then you are going to be liable for it. This is particularly so in the area of newborn babies. Many doctors who are in that area feel effectively they are insurers of a perfect baby. If there is not a perfect baby they are going to get a law suit as a result. It is very difficult, under the way that the judges are operating a trial these days, for them to prove that they did not fail to do something that should have been done. That is a very enormous cost because if you calculate damages, you calculate the loss of future earnings. For a newborn baby that is an enormous amount. On the other hand, if you are talking about a retired person, the damages are often not that great. One of the main factors in damages is economic damages and loss of earnings and there are no loss of earnings if you are in retirement. You are receiving money under pensions and other things and you will continue to receive that kind of money regardless of malpractice. And in fact in dealing with the elderly, that mitigates a little bit of the

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malpractice. On the other hand with a very sympathetic plaintiff in that situation, when you have an elderly person who has been injured, juries who want to give away money can always find a way to do so. I think group punitive damages is a potential problem.

FROM THE FLOOR: Federal legislation should preempt state legislation. Byzantine state laws have slowed down product development.

MR. FERRARA: Well that might be something that could be done. Perhaps there could be some kind of uniform system that promotes the development of long-term care insurance. Some states that have talked about offering this combined life insurance, long-term care insurance product have been turned down because the bureaus have a feeling that something tricky is going on there. This seems to be contrary to the kind of public policy you should be promoting. So that might be something that could be done.

FROM THE FLOOR: How in an insurance context can we control utilization?

MR. FERRARA: One of the ways you can try to do that, control utilization, is by having a trade-off benefit. In other words, instead of giving an open-ended benefit, just for nursing home care, have something like they were talking about -- in this policy you get less life insurance if you get more nursing home care benefits -- then you have a trade-off. That begins to control it. With home health care or nursing home care, one of the things a lot of policies do, is they provide a specific dollar amount. That seems to be a more valid type of insurance coverage because you are charged a daily fee for nursing home care and your liability is more controlled under that situation. Government has a terrible problem trying to control utilization because they are subject to politics and they are subject to lobbying. People feel that they are being treated unfairly and their congressman is going to go to bat for them. Bureaucrats have had a very difficult time saying no because of the pressures imposed on them from politics. The government is not going to go out of business. You may go out of business when they tax you, but the government is not going to go out of business. So then they have less concern about giving away their money. So you need to have a mechanism within the private sector approach to this that can control utilization as well.

Well I hope that I encouraged you all to work on these and other ideas. We have a big need for your help to deal with this issue.

FROM THE FLOOR: If calculations are at age 65, it would cost 20% more for a long-term care rider on a universal life insurance policy.

MR. FERRARA: How long do you pay for that 20%? Do you pay that until retirement, so if you sign up at age 55, you pay 20% more for your life insurance until age 65 and then you are covered or do you pay the 20% more throughout retirement years as well?

That seems like a very reasonable charge; I mean that is feasible through the private sector. Whether the public really wants this coverage is another issue. I mean you have a lot of politicians talking about this. But it would have to be evaluated as to the extent of actual demand in the marketplace. If the government would make their policy clear -- that the government is going to provide for those who don't have the resources, and that if you do have resources you are going to have to make a provision in the private sector -- that would encourage the development of this kind of thing. But it seems to me that is a feasible financial charge, asking people in the private sector to begin to deal with. It also seems that if you get people to start doing this in their 50s that makes the whole financing situation much more feasible. I think we should have more government incentives to try. If people could use money in their IRAs, for example, to pay for nursing home care insurance, on a nontax basis, that would encourage people to begin to take advantage of these types of options.

The Colonial American decision under which reinsurers are apparently facing a double taxation burden is certainly something that has to be addressed if we are going to have a viable market. We've got to make sure that these people in Congress who are working on this know about this.

So the question is, is there really a solution to this problem, given all the capital that is already being accumulated to propose another capital accumulation requirement? The government must make its policy clear that you are responsible if you are a person with some resources. I think

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that is definitely true. I think that this whole thing has to be defined. I think that there is a significant portion of the population that is not going to want to have to pay for any kind of insurance. There are a lot of resources that are already being accumulated and maybe it is inappropriate to ask people to have another vehicle to accumulate more resources. But I think the concern out there is a typical estate preservation concern. You only buy fire insurance if you've got property to protect. And you only buy life insurance if you've got a substantial income that your family is used to that you want to protect. In other words, insurance is for people with resources primarily. A product like health insurance is for everybody. I can see a valid need for people who have \$60,000 and don't want it to be wiped out. I would like to give \$10-\$15,000 to someone who can then make sure that the rest is going to be protected from this cost. That is where the real service is to be provided -- to help people to protect the assets they already have. And since you are dealing with people who already have assets there is something to work with there. And that is what the vehicle needs to be.

MR. CHALKE: If in fact the public decides it doesn't really want to purchase this kind of coverage the government says, "well that proves the private market has failed," and then the government will end up stepping in.

MR. FERRARA: When the baby boom generation retires, the one thing that is going to stop the government from stepping in is that it is going to cost so much more because there will be so many people in retirement. Milton Friedman recently gave a talk, and he said as the number of elderly grow, their political clout in demanding benefits is going to decline because it is going to become so expensive for everyone else to provide their demands. His argument is that as the foreign population has declined, to a very tiny proportion of the population, they become far more effective in getting government benefits because the cost of giving them their benefits is so small and they are a very concentrated and effective lobbying force. Whereas 60% of the population cannot have the government subsidize them heavily because it costs too much on the other 40%. And I think there is some logic to that. The whole public choice analysis of the way the government system works is that you are most effective in getting benefits when you have a concentrated special interest. But if you have too large of an interest it just costs too much and then what you give each one in that interest is too small to make them really fight for it that much. Even today, government just can't come up with the money for this thing and contrary to what people are saying, they are not going to have this program and adopt it.

FROM THE FLOOR: The fear is that if you go into this market as an insurer, the government may change the rules on you.

MR. FERRARA: Maybe there will be a court decision which says you thought your liability was this, but we are now going to have your liability much larger than that. You are not fulfilling the need, or maybe the government will legislate to expand what you thought was a limited obligation into a larger obligation. And both the point that Shane raised and this are problems that are created by government in a society by the uncertainty of what the government is going to do and the problems that it is going to create. That can be dealt with if we can try to get Washington to be more clear and to the point. But I think there are some things you can do with the policies as well to limit that. If the policies are defined so that you get \$75 a day if you qualify for nursing home care, it is more difficult to raise that obligation. I think there ought to be an inflation rider on these policies somehow. So don't guarantee them the daily rate today for an average nursing home because by the time they retire that is only one-third of the rate of a nursing home. There ought to be some way of trying to deal with that. So there is that effort but also I think that the insurance industry has to be more aggressive in dealing with public policy. The industry tends to be behind the eight ball. People have to begin to think of how we are going to preempt these problems the government is creating because the problems are otherwise going to pile up and there needs to be more effectiveness in dealing with these kinds of public issues.

FROM THE FLOOR: There is the danger of the government coming in and just sort of taking over the business once you begin to create it.

MR. FERRARA: That is very helpful for me to hear because I can use that when I talk to people back in Washington; they are once again the problem. And I think that is a problem, uncertainty about what the government is going to do.

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What is going to happen in the spring when this commission comes out and gives its report is they are going to propose taxing somebody to give benefits to somebody else, and in my feeling that is ultimately not going to fly. They are already putting in legislation to try and develop the private market. And what I think the industry needs to do is to tell them now what they need to do to at least help on this issue so that we can put it out there on a reasonable basis and see if it can flower and develop. And it may not all be just through insurance, it may be through other vehicles that deal with assets in certain ways to provide people the resources when they need them.

FROM THE FLOOR: When you say definition of life insurance rules are you talking about a tax issue?

MR. FERRARA: I have heard about that. That is another good issue, another good pointer to try and put in the policy mix. I think all these things need to come forward and people need to talk about these now so that we can give a serious try in the private market and these real problems can be identified. Some of the people who are offering that combined life insurance and nursing home care policy mentioned a state regulator problem.

FROM THE FLOOR: Would you propose the strategy of the industry to be pro-active?

MR. FERRARA: I think that there needs to be more of an effort to explain the valid business to the public and so it is largely an idea of attitude. You approach it defensively, like I have no right really to be in business and make a buck, then you are already ten steps behind. You need to approach it as, this is a good service and you get fair value for it. Explain the business to the public. The insurance industry needs to be on the forefront in making the proposals. In other words define the issue. The whole issue in politics becomes what issues? Whose proposals are we debating? This is one of the things where Reagan was so good. Whether he won or lost, when he was President, it was always his issues that they were debating. They were debating aid to the contras, tax cuts, and spending cuts. He lost he won because they weren't debating the other side's issues, they were debating his issues. This is the key to the whole thing. Get the proposals out there, and get the debate focused on proposals that will expand the market and more viable.

One of the things that really puzzles me the most is Social Security survival benefits for people under 65. I just can't understand why the government is doing that. It is just a pure life insurance function. It is one thing for people who are 70 and 80; there are survivor benefits for them. For a guy who is 35 and working and who has two kids and the government promises him survivor benefits, the government is just taking part of the private insurance market and putting it in the public sector without any flexibility for people to make any choice. There isn't any competition in the system. That is just a pure life insurance function which is done well by the private sector. The industry needs to be aggressive in defining areas like this where it can do a good job. Promote publically the idea of advance proposals that will begin to help stimulate a private market to take over these functions such as in long-term care.

I think the health care account proposal that I was talking about before is becoming more and more of a timely proposal. Many people feel that Medicare really is in deep trouble. It is badly underfunded. There is only so far they can go. The doctors hate it and the patients hate it because they don't feel they really get the coverage. It is amazing that \$80-\$90 billion is spent a year on Medicare and according to the Harvard School of Public Health, they pay as much or more of their income for medical care today, as they did before Medicare was adopted. So clearly Medicare has failed to reduce the burden that you had when it was adopted. They thought that was going to be the function of the program. The doctors are not happy with it, the government feels it is being bankrupted by it and the taxes are already too high on the workers. There is going to be more of a focus on how we can get private insurance to begin to take over more of these functions. Maybe the public system has gone too far.

FROM THE FLOOR: An option is the IRA could use the cumulative funds to buy a long-term care policy.

MR. FERRARA: I think that is a very different proposal particularly if you can get people early on to start making some minor contributions to what is going to be a long-term policy. I think that would help to reduce the costs on them if it is just one part of an overall package. Perhaps the insurance company can get into the IRA business and provide people a range of services with their IRA. They come back with IRAs they ought to make them a vehicle that is more flexible.