



**Statement to the House Committee on Energy and Commerce, Subcommittee on Health**

**The Implementation and Sustainability of the Community Living Assistance Services and Supports (CLASS) Program**

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***The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.***

## Summary

The Community Living Assistance Services and Supports (CLASS) program would provide persons with functional limitations cash assistance to help them remain living in their communities. CLASS is financed solely by enrollee premiums, with no federal subsidy. The program is unsustainable and will add substantially to the budget deficit in the coming years. Without major program changes, CLASS will face a financial crisis that could lead to a financial bailout rivaling anything we have seen to date.

- Because CLASS prohibits underwriting and charges the same premium to enrollees of the same age regardless of their health status, the program will primarily attract people who are most likely to need benefits—a problem known as adverse selection.
- To keep the CLASS Independence Fund solvent, premiums will rise sharply as healthier people refuse coverage or drop out of the program. That will create a death spiral of rising premiums and declining participation that will cause CLASS to fail.
- Despite remaining solvent, CLASS will generate growing budget deficits. Premium receipts will not keep pace with program outlays, even though no benefits will be paid for the first five years.
- Warnings about defects in the design of CLASS have been raised by CBO, the CMS chief actuary, the President's Fiscal Commission, the American Academy of Actuaries, and the Secretary of Health and Human Services. Proposed changes may be too little too late.
- Repeal is the only logical alternative. It is far better to repeal a defective program than to let it repeal itself through fiscal failure.

Thank you, Chairman Pitts, Ranking Member Pallone, and members of the Subcommittee for the opportunity to speak this morning on the fiscal consequences of the Community Living Assistance Services and Supports (CLASS) Program.

I am Joseph Antos, the Wilson H. Taylor Scholar in Health Care and Retirement Policy at the American Enterprise Institute (AEI), a non-profit, non-partisan public policy research organization based in Washington, D.C. I am also a member of the panel of health advisers for the Congressional Budget Office (CBO), and I was formerly the Assistant Director for Health and Human Resources at CBO. My comments today are my own and do not necessarily reflect the views of AEI, CBO, or other organizations with which I am affiliated.

CLASS is a new federal long-term care program that is financed solely through enrollee premiums. Because the program collects premiums in advance of benefit payments, CLASS reduces the budget deficit in the near term. Over the longer term, CLASS increases the deficit and worsens the fiscal crisis we are already facing due to the mounting costs of Medicare, Medicaid, and Social Security.

The goals of CLASS are laudable. Persons with functional limitations need assistance if they are to remain living in their communities. CLASS would provide a cash benefit that could help those individuals purchase a variety of non-medical services and supports, such as personal assistance services, housing modifications, and transportation. That could relieve the burden on families and delay the need for institutionalization.

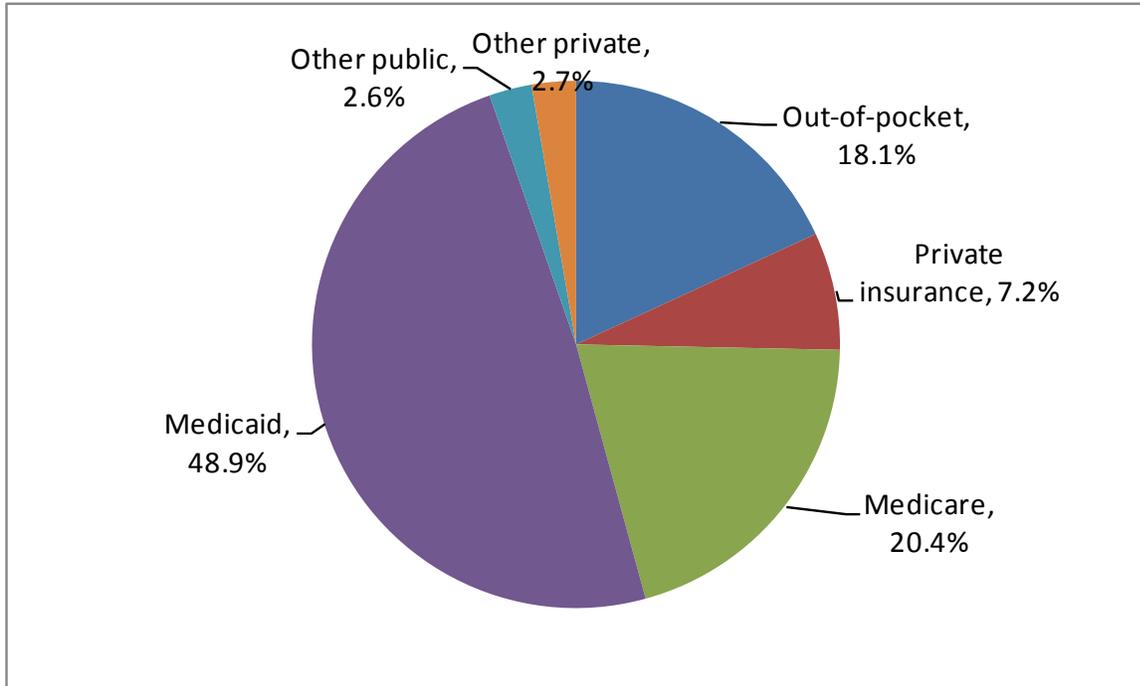
But few people will benefit unless the program is attractive to a broad population who can share the cost and keep premiums affordable. Instead, CLASS will primarily enroll an older and sicker population who will take full advantage of the benefit. Younger, healthier people are much less likely to enroll in CLASS, which will drive up premiums sharply. This adverse selection will create a death spiral of rising premiums and declining participation that will doom the program as it is now structured.

### **Long-Term Care Insurance and the CLASS Program**

Government programs, and particularly Medicaid, cover the bulk of long-term care expenses (see Fig. 1). Private insurance, which is purchased by about seven million people, pays for just over seven percent of the total.<sup>1</sup> This low take-up rate reflects weak demand in the market for long-term care insurance that will also impact sales of CLASS coverage.

A major factor reducing demand for private long-term care insurance is the prospect that Medicaid will pay for services when the need arises, perhaps coupled with an unwillingness to actively plan for the distant possibility of becoming disabled. Long-term care needs are difficult to predict and may not arise for decades. Many consumers appear willing to gamble that their care will be paid for (or that they may not need such care) rather than paying thousands of dollars in premiums.

Figure 1. Long-Term Care Spending by Source of Payment, 2005



Source: *Fact Sheet: National Spending for Long-Term Care*, Health Policy Institute, Georgetown University, February 2007.

Willingness to buy coverage increases with age. About 50 percent of consumers who apply for private long-term care insurance are between age 50 and 64, undoubtedly because the prospect of needing services is more plausible to older persons who may also have the financial means to pay the premiums.<sup>2</sup>

CLASS offers a less generous benefit at a price that might initially be somewhat lower than typical in the private insurance market. A cash benefit of at least \$50 a day is paid to enrollees through a debit card account. The benefit amount will be based on the number of functional limitations that an individual has. In contrast, two-thirds of private policies offer daily

benefits ranging from \$100 to \$199. CLASS benefits continue for as long as the individual needs care, whereas private coverage typically limits the benefit period—generally five years or less.<sup>3</sup> However, enrollees in CLASS may not draw a benefit until they have paid premiums for 5 years (3 of which while they are still working). Private insurance generally requires a 90 day waiting period before benefits will be paid.

Premiums are intended to be affordable, under the assumption that the program will be broadly popular. Once someone enrolls in CLASS, his premiums remain constant over time unless there needs to be an upward adjustment to ensure the program's solvency for 75 years.<sup>4</sup> Premiums may also increase if an enrollee drops out for three or more months and re-enrolls.

There is considerable uncertainty regarding how CLASS coverage will be priced since a product with similar features has not been marketed previously. CBO estimates that the average monthly premium would be \$123 for benefits of \$75 a day.<sup>5</sup> The chief actuary of the Centers for Medicare and Medicaid Services (CMS) estimates that an average premium level of about \$240 per month would be required to adequately fund the CLASS program.<sup>6</sup> Those estimates compare to private premiums that average \$184 for a daily benefit that is likely to be somewhat larger than \$150.

All workers age 18 or older are eligible for CLASS, as long as they earn enough to pay Social Security taxes for one quarter—about \$1,200 a year currently. CLASS coverage is guaranteed issue, which means that no one can be rejected because of pre-existing conditions.

CLASS will be sold through participating employers, with all employees automatically enrolled unless they opt out.

### **An Unworkable Program**

With these specifications, CLASS is not going to be an easy sell. The “nudge” of auto-enrollment will not work. It may make workers more aware of long-term care insurance and future needs, but only the first time it is raised. After that the CLASS form will be largely ignored, just like the rest of the routine paperwork associated with hiring. Moreover, unlike automatic enrollment in 401(k) savings plans which typically requires a minimal contribution, CLASS premiums will be substantial and difficult to overlook.

The cost of CLASS will make it a nonstarter for the vast majority of workers, particularly those who are younger and healthier. Premiums are lower for those who enroll at younger ages, since they will have more years to pay into the program. But everyone in an age cohort pays the same premium regardless of their risk of needing long-term care services. The only exception is any enrollee with an income under 100 percent of the federal poverty level, who pays \$5 a month (inflation-adjusted after the first year). Other enrollees’ premiums must be increased to subsidize those individuals.

This premium structure exacerbates the adverse selection that can be a problem in any insurance market. Those who are at greater risk will pay favorable rates, and are more likely to enroll. Those who are healthier will pay unfavorable rates, and are less likely to enroll. A

healthy person who wants long-term care insurance is likely to find a better deal in the private market.

Since CLASS is guaranteed issue with no underwriting, it will soon become obvious to many workers that prompt enrollment when the program is first offered is not in their best interests. The calculation for a 40 year-old illustrates the point. If she enrolls then, she will pay premiums for perhaps another 40 years before receiving CLASS benefits. If she waits until she is 50, she pays a higher premium but for fewer years. A ten-year delay in enrollment could save \$15,000 in premium payments, which must be weighed against the greater risk of becoming disabled before qualifying for benefits if she delays.<sup>7</sup>

Given these imponderables, many middle-aged people are likely to refuse enrollment when first offered, if only because the proper course is unclear. Younger workers will have less difficulty deciding not to enroll immediately, knowing that they cannot be refused later on. Reflecting these facts, CBO assumes that 3.5 percent of the adult population will participate in CLASS, as compared with four percent participation in the current employer-sponsored private long-term care insurance market.<sup>8</sup> The CMS chief actuary assumes a more conservative two percent participation rate.<sup>9</sup>

The framers of the CLASS legislation wanted to make it easy for people to get coverage, but they ignored economic realities. Guaranteed issue with no underwriting virtually guarantees a selection death spiral, with premium increases that will drive out all but those who are most likely to need services.

Ironically, this problem is exacerbated by the requirement that premiums be set to ensure solvency over 75 years. That guarantees steep price hikes as the mix of enrollees shifts toward those with greater health risk. As premiums rise sharply, healthy people do not enroll and those who did will drop their coverage as the net value of the coverage declines. Continued shifts in the composition of the covered population will necessitate even steeper premium increases, reinforcing the financial pressures on CLASS and ultimately leading to collapse.

The rules of the program could be changed to mitigate the impact of adverse selection on CLASS, but there are no easy fixes. The most obvious cure is to allow underwriting, perhaps coupled with an initial open enrollment period. A longer waiting period before benefits are available during which premiums are paid—perhaps 10 or 15 years—would also reduce selection, although it is notable that private insurers generally do not require long waiting periods.<sup>10</sup>

Some argue that CLASS needs more funds to advertise its product. The President's 2012 budget requests \$93 million to fund an advertising campaign for the program. Such an effort would only be effective if the product is attractive to consumers.<sup>11</sup> To accomplish that, the government should hand the reins over to private insurers who have an incentive to develop products that can sell. But the potential market is limited, as our current experience with private long-term care insurance demonstrates. Private companies could run this program more efficiently, but if Congress wants millions of additional people to have coverage it will have to find the money to subsidize them.

Congress also could move from persuasion to compulsion by mandating CLASS purchase by all workers or perhaps everyone.<sup>12</sup> That eliminates the adverse selection problem, replacing it with a host of other problems that plague the health insurance mandate—without the possibility that competition among private plans could promote efficiency.

If adverse selection is not addressed, CLASS will face a funding crisis. Unless Congress reneges on a public promise and fails to pay benefits after having collected billions in premiums, it would have no choice but to provide a financial bailout rivaling anything we have seen to date.

### **Budget Impact**

At the time of enactment, the Congressional Budget Office estimated that the CLASS program would reduce the federal deficit by \$70 billion through 2019.<sup>13</sup> More recently, CBO estimated that CLASS will collect \$112 billion in premiums and spend \$28 billion over the 2012-2021 period, resulting in a reduction in the federal budget deficit of \$84 billion.<sup>14</sup>

In the near term, the CLASS program reduces the federal deficit because premiums are collected in advance of benefit payments. Individuals must be enrolled in CLASS for at least five years before they may collect benefits. Over the longer term, the CLASS program increases the federal deficit as premiums fall short of outlays. CBO estimates that the program will generate budget deficits during its third decade of operation, while the CMS chief actuary projects deficits starting in 2025.

This seems to contradict one of the key protections built into the law. The Patient Protection and Affordable Care Act (PPACA) requires the Secretary of Health and Human Services to set premiums annually that ensure that the program is solvent over the subsequent 75-year period. If the program is solvent, how can it generate budget deficits? The explanation lies in the difference between budget and trust fund accounting.

PPACA establishes a trust fund known as the CLASS Independence Fund (“Fund”) that will receive premium payments and disburse benefit amounts, in the same way that Medicare’s Supplementary Medical Insurance Trust Fund operates. Surpluses that accumulate in the Fund are invested in nonmarketable Treasury securities—essentially IOUs that obligate Treasury to find funds to cover the operation of CLASS when premiums no longer cover expenses.

That money does not sit idle in a bank account. Instead, Treasury uses the Fund’s surpluses to finance other ongoing operations of the federal government. Although premiums would be set to maintain a positive Fund balance for 75 years, that balance includes the excess premiums from the first few years that were *in fact* spent, and it includes imputed interest on Treasury securities that is not *in fact* new money.

Solvency means that annual CLASS program expenses would be met through a combination of premium income and interest earnings on the assets of the Fund. The federal budget impact, in contrast, is the difference between premium receipts and program outlays. The CMS chief actuary observes that if the Fund is adequately financed and program solvency is

maintained, the federal budget would have a net savings each year prior to 2025 and a net cost each year thereafter.<sup>15</sup>

An argument can be made that CLASS should be financed through an independent insurance fund outside of government that invests its reserves privately.<sup>16</sup> While that would prevent the diversion of CLASS premiums into other federal programs, it is a half measure at best. Without changing the program rules to ameliorate adverse selection, CLASS would still face a financial crisis in the years to come. Retaining CLASS as a federal program would make a federal bailout virtually inevitable regardless of where its funds are invested.

## **Conclusion**

The defects in the design of CLASS are widely recognized. Both CBO and the Office of the Actuary in the Centers for Medicare and Medicaid Services (CMS) agree that program spending will exceed revenue in the next 15 or 20 years.<sup>17</sup> The President's National Commission on Fiscal Responsibility and Reform ("Fiscal Commission) calls CLASS unsustainable.<sup>18</sup> The American Academy of Actuaries and other experts point to serious defects in the program that will lead to its failure to remain self-funded and actuarially sound.<sup>19</sup> Even prominent members of the Senate raised concerns that enacting CLASS would not be fiscally responsible.<sup>20</sup>

In a hearing before the Senate Finance Committee on February 16, 2011, HHS Secretary Kathleen Sebelius agreed that the CLASS program as legislated is "unsustainable absent massive

taxpayer infusion” of funds.<sup>21</sup> She indicated that the administration is considering making some changes to the CLASS program. Such changes may include tighter eligibility standards to ensure that only active workers may enroll in CLASS and replacing flat lifetime premiums with premiums that increase with inflation.<sup>22</sup>

There is no guarantee that such adjustments to the CLASS program would resolve the financial instability that is built into the program. Indeed, there is a risk that attempts to fix problems caused by adverse selection in CLASS could unintentionally exacerbate them.<sup>23</sup> Instead, more fundamental issues must be addressed, including the role of Medicaid in crowding out private long-term care insurance.<sup>24</sup>

Repeal is the only logical alternative. The Fiscal Commission advised the President that if the CLASS program cannot be made credibly sustainable over the long term, it should be repealed. Dr. Alice Rivlin and Rep. Paul Ryan (R-Wisc.) recommended repeal of CLASS in their health reform proposal, noting that the program is “a new unfunded entitlement [that] should be repealed because it will increase the deficit over the long term.”<sup>25</sup> It is far better to repeal a defective program than to let it repeal itself through financial failure.

Good intentions will not prevent fiscal ruin. The CLASS program aims to help pay for personal care for the frail elderly and others with disabilities, but the program is fundamentally flawed and inadequately financed. Congress should not wait for a crisis to act.

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<sup>1</sup> Estimates of the number of active long-term care insurance policies vary; see American Association for Long-Term Care Insurance, 2008 LTCi Sourcebook, available at <http://www.aaltci.org/long-term-care-insurance/learning-center/fast-facts.php>, and Anne Tumlinson, Christine Aguiar, and Molly O'Malley Watts, *Closing the Long-Term Care Funding Gap: The Challenge of Private Long-Term Care Insurance*, Kaiser Commission on Medicaid and the Uninsured, June 2009.

<sup>2</sup> American Association for Long-Term Care Insurance, previously cited.

<sup>3</sup> Ibid.

<sup>4</sup> As discussed in the concluding section of this testimony, HHS Secretary Kathleen Sebelius recently indicated that the department is considering indexing premiums to inflation.

<sup>5</sup> Congressional Budget Office, "Additional Information on CLASS Program Proposals," letter to the Honorable George Miller, November 25, 2009.

<sup>6</sup> Centers for Medicare and Medicaid Services, "Estimated Financial Effects of the 'Patient Protection and Affordable Care Act,' as Amended," memorandum from Richard S. Foster, April 22, 2010.

<sup>7</sup> Author's calculation based on Alicia H. Munnell and Josh Hurwitz, "What is 'CLASS'? And Will It Work?" Center for Retirement Research at Boston College, February 2011. Monthly premiums are estimated to be \$150 and \$159 for enrollees between 40 and 49 and between 50 and 59, respectively. The undiscounted amount of premium payments for an enrollee between age 40 and age 80, when benefits are assumed to begin, is \$72,000. The comparable figure for an individual enrolling at age 50 is \$57,240. Similar results can be calculated using estimates from American Academy of Actuaries, "Critical Issues in Health Reform: Community Living Assistance Service and Supports Act (CLASS Act)," November 2009.

<sup>8</sup> Congressional Research Service, "Community Living Assistance Service and Supports Act (CLASS) Provisions in the Patient Protection and Affordable Care Act," June 4, 2010.

<sup>9</sup> Centers for Medicare and Medicaid Services, previously cited.

<sup>10</sup> This was suggested in American Academy of Actuaries, "Re: Actuarial Issues and Policy Implications of a Federal Long-Term Care Insurance Program," letter to the U.S. Senate Committee on Health, Education, Labor, and Pensions, July 22, 2009.

<sup>11</sup> Munnell and Hurwitz, previously cited.

<sup>12</sup> This was also suggested by the American Academy of Actuaries, 2009, previously cited.

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<sup>13</sup> Congressional Research Service, 2010, cites a letter from the Congressional Budget Office to Senator Harry Reid dated March 11, 2010. The latter document does not appear to be publicly available.

<sup>14</sup> Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011.

<sup>15</sup> Centers for Medicare and Medicaid Services, previously cited.

<sup>16</sup> This idea has been advanced by Howard Gleckman, “Don’t Repeal Long-Term Care Program,” McClatchey-Tribune, March 8, 2011, available at <http://www.vindy.com/news/2011/mar/08/don8217t-repeal-long-term-care-program/?print>.

<sup>17</sup> Congressional Budget Office, “Additional Information on CLASS Program Proposals,” letter to the Honorable George Miller, November 25, 2009; and Centers for Medicare and Medicaid Services, previously cited.

<sup>18</sup> National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010.

<sup>19</sup> American Academy of Actuaries, “Re: Patient Protection and Affordable Care Act (H.R. 3590) and Affordable Health Care for America Act (H.R. 3962),” letter to the Honorable Nancy Pelosi and the Honorable Harry Reid, January 14, 2010; Munnell and Hurwitz, previously cited.

<sup>20</sup> Senators Conrad, Lieberman, Landrieu, Bayh, Lincoln, Ben Nelson, letter to the Honorable Harry Reid, October 23, 2009 (available at [http://www.politico.com/static/PPM145\\_chris\\_memo1.html](http://www.politico.com/static/PPM145_chris_memo1.html)).

<sup>21</sup> A clip of the exchange between Secretary Sebelius and Senator John Thune (R-S.D.) is available at [http://ltpartners.typepad.com/group\\_longterm\\_care\\_insur/2011/02/class-act-senate-exchange-hhs-secretary-sebelius-and-sen-john-thune.html](http://ltpartners.typepad.com/group_longterm_care_insur/2011/02/class-act-senate-exchange-hhs-secretary-sebelius-and-sen-john-thune.html).

<sup>22</sup> Robert Pear, “Long-Term Care Needs Changes, Officials Say,” *New York Times*, February 21, 2011.

<sup>23</sup> This point is made by Allen Schmitz, “Adverse Selection and the CLASS Act,” Milliman Health Reform Briefing Paper, December 2009.

<sup>24</sup> Jeffrey R. Brown and Amy Finkelstein, “The Interaction of Public and Private Insurance: Medicaid and the Long-Term Care Insurance Market,” *American Economic Review*, June 2008.

<sup>25</sup> Alice Rivlin and Paul Ryan, “A Long-Term Plan for Medicare and Medicaid,” November 17, 2010, available at <http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/MemberStatements.pdf>.