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Before the House Committee on Energy and Commerce, Subcommittee on Health

March 17, 2011 Hearing on "The Implementation and Sustainability of the New, Government-Administered Community Living Assistance Services and Supports (CLASS) Program"

"A Framework for Employers in Deciding Whether or Not to Participate in the CLASS program"

Chairman Pitts, Ranking Member Pallone and other Members of the Subcommittee, I appreciate the opportunity to share information and thoughts with you on the new voluntary long-term care insurance program to be offered by the federal government in 2012 called CLASS. I am Director of Retirement Research at Towers Watson, a firm consulting on employee benefits, and a Member of the Social Security Advisory Board. In this testimony, however, I am not representing either organization; rather, I am speaking as someone who has done research and written on long-term care insurance and disability risks for more than fifteen years and, more recently, about the CLASS legislation.[1]

In this statement, I plan to set forth a framework that could be used by employers in deciding whether or not to participate in the CLASS program. I cannot be more specific than this broad framework at this time because the actual considerations by employers can only be made after the details of the program are finalized, become widely available and are explained by the Department of Health and Human Services (DHHS). Nonetheless, I hope the framework gives you some indication of the types of questions that employers are likely to want answered if they are to offer insurance to their workers through this federal program.

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[1] See Mark J. Warshawsky, "Will the 'CLASS' Program Succeed? Is It Sustainable?" *Towers Watson Insider*, December 2009.

Some Background about Current Employer Offerings and Employee Behavior with Respect to Long-term Care Insurance

First, however, it will be helpful to review some statistics about current offerings of private long-term care insurance by employers to workers. According to the Benefits Data Source of Towers Watson, as of 2010, about 50 percent of large employers offer but do not subsidize long-term care insurance to their workers; another 4 percent provide such insurance with either a partial or full subsidy to workers. The fact that the vast majority of employers either do not subsidize or even offer long-term care insurance to their workers, despite a tax advantage to the worker from any employer subsidy, reflects that this insurance is considered a convenience benefit for employers. That is, long-term care insurance is not a core benefit plan nor is it generally thought to provide a significant business advantage to the employer in offering it, beyond good will and convenience to employees. By contrast, other benefit plans are highly subsidized and are near-universal among large employers because the plans are considered to give significant advantages to the employer – for example, health insurance – to maintain the health and productivity of current workers – or retirement plans – to encourage retirement of workers when their productivity begins to decline. Also the demand for, and take-up of, health and retirement benefits is high among workers because the benefits are well-understood and appreciated widely.

By contrast, experience to date with take-up by employees in employer-offered long-term care insurance plans has been quite modest. Even in large organizations with well-paid and well-informed employees for whom Medicaid is unlikely to be thought a source of long-term care coverage, take-up rates have not exceeded 5 or 6 percent. This is despite the fact that employer-offered policies have the advantage over commercial individual policies that little or no underwriting is done in the workplace. Indeed, aside from Medicaid or, in a limited way, Medicare, most long-term care insurance coverage to households currently comes though insurance policies sold to individuals and couples in the commercial market, often around the time of retirement, and not through employer plans.

Other witnesses at this hearing have already described or will describe the intended structure of the CLASS program – its benefits, premium structure, eligibility, budget impact, governance, and so on. For my purposes here, it is important to note that the legislation provides that workers can be enrolled in the program via one of two methods. Employers who decide to participate in the program would automatically enroll their workers, through payroll deduction, with workers having the right to opt out; such automatic enrollment is now common in many 401(k) plans. Self-employed workers and those whose employers do not participate in the program could join through an individual enrollment mechanism to be established by the federal government. According to my understanding of the language of the law, employers could only participate in the program if they agree to automatically enroll their employees, although it is unclear whether this would apply to all current employees or just new employees – most 401(k) plans employing automatic enrollment choose the latter approach. Also, according to my understanding of the legislative expectations for the program and the score given to the program by the Congressional Budget Office (CBO) as part of the broader health reform legislation, it is thought that most of the enrollment in the program (projected by CBO to be 6 percent of the Nation's working population in 2019) will be through employers.

A Framework for Employer Choice to Participate in the Program

An important overall consideration for employers is whether the DHHS, as the primary administrator of the program, will aggressively promote the need for, and the benefits of, long-term care insurance, directly with workers. For example, will the Department, within the legislative restrictions on marketing expenses by the program, or others put forward clever and effective advertising campaigns directed to the public? Will DHHS get expert and celebrity endorsements, and orchestrate extensive speaking tours by senior government officials, again directed to the public? Is it possible to add informative and candid inserts from DHHS into the various regular communications workers get from the federal government? Absent such promotions, many employers, even those currently offering long-term care insurance, are unlikely to want to participate in an automatic enrollment program when the vast majority of workers are likely to opt-out. Such participation would be viewed as a bother and nuisance and cost to both the employer and the worker – far from the convenience benefit desired.

As a related matter, it is widely recognized that the extent of adverse selection from high-risk workers that the program is likely otherwise to experience would be mitigated, perhaps even eliminated, if demand for the benefit plan and therefore enrollment in the program by healthy workers is high. Adverse selection, that is the tendency of those more likely to claim benefits, such as people with chronic conditions or disabilities, to purchase insurance, threatens the viability of the program. Employers would want to avoid putting their employees in possible scenarios where benefits would be cut and premiums increased by the government in the future if adverse selection turns out to be even worse than expected. This is relevant to employers also because there is a good alternative – private insurance, where adverse selection is controlled through either selective offering to only employees with significant labor force participation (and therefore a high likelihood of good health at time of purchase) or underwriting.

It is worth spending a few moments to better understand why the CLASS program, as structured in law, is particularly subject to adverse selection. The program is available to students and to all workers, even those with quite limited attachment to the labor force, regardless of health status. Moreover, the program allows the non-payment of premiums for extensive periods of time while preserving eligibility to benefits. And, while there will be an adjudication process, of unknown stringency, for claims, benefits would be paid automatically if the individual were discharged from a hospital (for long-term care), nursing home, or an institution for mental diseases. So, for example, a 55-year-old individual worker could be partially retired and already modestly disabled by a chronic disease that is likely to grow worse with time, pay premiums consecutively for 24 months, stop paying premiums for a couple of years, have worsened disabilities, pay 12 months of premiums on and off for a couple of years, become severely disabled, retire completely, pay for two more years, get discharged from a hospital for long-term care, and then automatically get full benefits. The fact that this program is designed to be so open, even to those with disabilities, is precisely what poses the threat to the viability of a voluntary program, without subsidies, when there are private market alternatives constructed to avoid adverse selection. HHS Secretary Sebelius recently gave a speech promising to fix some of these design issues in the program; employers and others will be looking closely at whether the fixes, within the constraints of the law, are sufficient to the acknowledged problem.

Employers will be comparing the benefits and premiums and administration for the federal program with those available in the private sector. This will be an intensely facts and circumstances evaluation and it is idle to speculate now on how it will come out. But it is worth noting that there are two structural considerations now known – one favoring the government program and one favoring private long-term care insurance. The government program will pay cash benefits that can be used for any purpose, even to pay family members for care, for the lifetime of the beneficiary. This desirable flexibility is in contrast to most private policies which must be used for specific types of care, such as nursing home or home health care given by licensed providers. By contrast, the level of benefits contemplated in the government program -- $50 to $75 a day – is unlikely to cover the actual cost of care for many disabilities – nursing home care exceeds $250 a day in many parts of the country, and home health care costs $15 or more an hour, and so on. Policy parameters in private insurance, on the other hand, can be selected to meet the expected costs appropriate to the region of the country and level of care desired by the insured.

Finally, employers must evaluate whether any long-term care insurance, public or private, is appropriate for their workers. Although most experts agree that insurance is conceptually an appropriate vehicle to protect against the uncertain costs of disability, when other government social welfare programs, such as Medicaid, are available, it is clear that the purchase of insurance is not always optimal.[2] In particular, for low- and moderate-wage workers who are unlikely to build up significant asset holding, Medicaid functions as reasonable long-term care insurance coverage, particularly considering the sacrifice that the insurance premium, estimated by the CMS actuary to be as much as $250 monthly or more, otherwise would represent during the working lifetime. As we climb up the wage ladder, this consideration is less important, but it might even apply to middle income workers who have large expenses during their working careers and do not mind the prospect of having to spend down to Medicaid eligibility.

Conclusion

The CLASS program for voluntary long-term care insurance sold by the federal government to workers is scheduled to come on-line by October 2012. Employers will need to assess at that time whether to offer this program to their workers on an automatic enrollment basis. Those organizations currently offering group long-term care insurance will also have to decide whether to drop such offerings or to ask their insurers to amend them to wrap-around the federal program. Employers will want to know whether the government will effectively promote the need for long-term care insurance directly to workers. Employers should compare benefits and premiums and administration for the

[2] See Jeffrey R. Brown and Amy Finkelstein, "The Interaction of Public and Private Insurance: Medicaid and the Long-Term Care Insurance Market," *American Economic Review,* 2008, 98(3), pp. 1083 – 1102 for a rigorous demonstration of this observation.

CLASS program with those in group long-term care insurance offered in the marketplace or even individual policies available. The cost and extent of coverage available in CLASS will be an important consideration. Employers should also evaluate the possibility that the CLASS program will not be stable – that because of structural flaws, premiums increases, benefit cuts or other curtailments could occur in the future. In this regard, the likelihood of such occurrences will be influenced importantly by the details of design fixes that Secretary Sebelius has promised. Finally, employers would need to judge whether there is room in their employees' paychecks for $200 to $250 monthly premiums for a voluntary long-term care insurance program when Medicaid coverage is available to many workers, and health care costs continue to rise rapidly. And, it is worth noting, employers must make this choice at the same time that other consequential change in the health care insurance and provision marketplace is occurring as the larger health care reform plan is being implemented.