I’ve known Claude Thau a long time and I think he has outdone himself on this piece. I had to share it on my website as it just makes so much sense – Phyllis Shelton

Claude Thau on the CLASS Act

I have spent my career as an actuary, executive, consultant and distributor in the insurance industry, focusing entirely on long-term care insurance (LTCi) for the past 15+ years. Nonetheless, it is difficult to comment definitely on a moving target and one with a lot of complexity. I have seen various versions of the CLASS Act over the years and my comments may not apply directly to the current design (in developing my comments, I reviewed the version of the CLASS Act that I found on Thomas as of 27Sep09 - http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1721- it was out-of-date at that time). With limited time and resource, I must observe that my analysis may be deficient and certainly has not been done with any mathematical modeling, although I’ve relied on some modeling done by others. I offer my knowledge, experience and insights because I am confident that at least some points are quite relevant.

Modeling has, unfortunately, proven to be of limited value in the past. Diligent efforts to predict the costs of Social Security, Medicare, Medicaid, etc. have had the following results:

1. Costs of the original program have been underestimated.
2. The environment has changed, increasing the cost.
3. The program has changed subsequently, increasing the cost.
4. The political process has been unwilling to deal with the problems.
5. Hence we have created huge unfunded liabilities, currently to the tune of $140 trillion, although Social

Security and Medicare were intended to be self-supporting.

6. Those unfunded liabilities are off-balance-sheet. Thus trend analysis of our national "deficit" and calculations such as the "deficit per household" ignore these burgeoning unfunded liabilities.
7. The nature of the programs has changed from their initial description. Programs that were supposed to be self-funded social insurance became increasingly means-tested directly or indirectly, a trend that will continue. For example, social security income is now taxed and there are proposals to increase social security taxation for the more affluent. Medicare Part B health insurance premiums vary based on the insured's income, not based on the insured's likely benefits.
8. The program affects the public psyche in perhaps unintended ways.

Because I am dealing with a "political" issue, some readers may wonder about my political persuasion as well as my credentials. My tendency is to be a social liberal and economic conservative. I consider myself independent but have voted Democratic more often than Republican. I have voted for Dennis Moore in each of his Congressional campaigns and voted for President Obama in the Kansas caucus as well as the general election.

Fundamentally, earlier versions of the CLASS Act have already proven to be seriously under-funded and it probably continues to be under-funded, as I will explain below. It also may devastate the private LTCi industry.

A committee of extremely well-respected actuaries with deep involvement in the LTCi industry did a study of the CLASS Act on behalf of the American Academy of Actuaries (AAA). The study concludes that the CLASS Act, as proposed, would become insolvent within 11 years, by 2021. The AAA estimates that the premium would have to be $160/month for a $75/day benefit. Based on my reading of the report and respect for the individuals involved, I believe that the projection is well-done. However, I believe that the $160/month conclusion is understated primarily because I believe that we need to ask slightly, but significantly, different questions.

1. One of the recent changes seems to be a requirement for actuarial solvency over a 75-year horizon. The AAA used that time frame to determine that the premium would need to be $160/month.

   I'm concerned about the 75-year premise. If you stop an analysis with future benefits still due, you generally understate the cost.

   The 2008 OASDI report showed an unfunded liability of $4.3 trillion 75 years into the future, but a $13.6 trillion unfunded liability for infinite horizon. Certainly the farther out you go, the less reliable the projection, but it is scary that the infinite horizon liability is more than triple the 75-year horizon liability. LTCi might be more back-ended than Social Security but less back-ended than Medicare.

   While the unfunded liability might triple (or worse) when extended to the infinite horizon, the additional premium necessary from initiation would be much less than triple. I've heard suggestions that the additional cost to be funded to the infinite horizon might be as little as $3/month (seems very surprising to me) and 10%/month (seems credible and encouraging). If it only takes an additional 10% to accomplish the goal of actuarial soundness based on current design and reasonable assumptions, we should, IF we proceed at all, proceed on that basis.

2. The AAA study determined the premium which would be necessary to fund the CLASS Act benefits. It did NOT determine the premium level that would result in the program being REVENUE-NEUTRAL to the government. Without criticizing the AAA (I believe they answered the question they were asked), I

must emphasize that I think the proper question is revenue neutrality.

The premiums for the CLASS Act coverage would be fully-deductible above the line (according to Section 201). Thus if a tax-payer's marginal combined state and federal tax rate is 30%, the government would net only 70% of the CLASS Act premium.

If 30% is a reasonable marginal tax rate to presume for the future (tax rates seem likely to rise) and we want the government to break-even, the CLASS Act is substantially more under-funded than the actuaries concluded. Tax-deductibility would require a $160 monthly premium to increase to about $230/month. Please note that this figure does not reflect the infinite horizon.

These costs would be partially offset by Medicaid savings. Such savings might offset sufficient Medicaid costs to more than balance the impact of the above tax deduction. However, a better way to reduce Medicaid costs is to discontinue making long-term interest-free loans to people who are not destitute, hence should not be on welfare. It is improper to treat people as destitute and limit how their loan can be used, when their assets collateralize the loan. See my paper on Medicaid Reform for further explanation.

3. Any deficits in the program would be "off-budget". The money cannot be used in any other way, unless the Senate overrules this restriction with 60 votes.

   Unfortunately, off-ledger programs are prone to becoming fiscal disasters. When unfunded liabilities are off-budget, it is too easy to overlook them. We currently have $140 trillion of unfunded liabilities on such programs.

The CLASS Act does not contribute to retiring our existing unfunded liabilities. Rather it seems very likely to add to those liabilities. Our current generations are consuming fiscal and environmental resources at the expense of future generations. We should discontinue that practice rather than expand upon it.

There could be good reasons for the government to invade the CLASS Act trust fund with a 60% vote and there might be "political" reasons which some people might not consider to be "good reasons". The restriction is helpful but is the type of assumption which allows a program to be implemented in good faith, but to fail to satisfy original projections.

4. Perhaps this wording has changed, but my most recent version states that if a 20-year projection indicates that more than 40% of the funds are required EACH year, then premiums can be increased. By that time, the claims as a percentage of the funds would likely be increasing each year, so 20 years further into the future, the ratio would probably be much higher than 40%.

    Requiring that there be no increase until benefits equaled 40% of the fund for the first time seems to require that there be no increase until the fund would be on the brink of running dry within a few years. So there would be little time for a price increase to have much benefit. A very huge premium increase would be required at such time.

    But the individual's premium is not allowed to increase more than 50%, nor to more than double the original premium. Any retired person over age 65 who has paid for 20 years would be exempted from the premium increase. So the law seems to require increases that it simultaneously forbids.

How much would a $75/day benefit help people and how would it impact the LTCi industry?

1. A $75/day benefit would be very meaningful for home care IF it keeps pace with the inflationary cost for home care. Home care costs, unfortunately, are likely to explode.

    In the study of 2008 Individual Long-Term Care Insurance sales that I co-authored with Bob Darnell of Towers Perrin, our background data shows that the home care maximum daily or monthly benefit was the same as the facility daily or monthly maximum benefit in 87.5% of the policies purchased.

    4.9% of the sales covered home care, but not facility care. Another 0.9% of the sales had a higher daily or monthly maximum benefit for home care than for facility care. So in 5.8% of the sales, the home care maximum benefit was higher than the facility benefit.

    In 5.5% of the policies, the home care maximum benefit ranged from 50% as much (most common) to 80% as much as the facility maximum benefit. And 1.2% of the policies covered only facility care.

    So the vast majority covered home care to the same degree as facility care and the others were nearly evenly split between having higher home care benefits and higher facility benefits.

    The trend in the industry is toward home care benefits. When buyers discuss their desires with insurance brokers, they heavily favor home care benefits at least as great as the facility benefit level, as reflected by the above data.

In the group LTCi market, it has historically been very common to have the home care maximum set at 50% of the facility maximum. The consumer had no voice in that decision. However, the insurance industry has been "listening" to consumer preferences. Hence the percentage of group certificates issued with the home care maximum daily benefit equal to the facility maximum daily benefit rose from 18.8% of the certificates in 2005 to 31.2% of the certificates in 2007.

In 2008, the average policy sold covered up to $150/day (or $4500/month) for home care or facility care. Thus a $75/day benefit in 2008 would have been half as high as what was issued in the individual insurance market. I would consider that to be meaningful coverage.

A $75/day benefit would have covered 3 to 4 hours of home care per day, which is meaningful support for a family burdened by caregiving responsibilities. The balance of care would come from the family or be paid for by the family.

A $75/day benefit would cover only 36% of the national average cost of a private room in a nursing home. In judging meaningfulness, consider that less affluent people would likely reside in a less expensive nursing home. Unlike home care costs, facility costs are related to real estate. So families could reduce their costs by selecting facilities in areas where real estate is less expensive. Many might get by in assisted living facilities which are generally less expensive (particularly for those who are not cognitively impaired).

There are limitations to relying on the average home care costs. Many people do not incur average costs. While average costs might be fine for pricing, they would not cover each person satisfactorily. There may be future pressures to increase the benefit levels.

Secondly, home care usage will be significantly higher to the degree it is covered by CLASS Act coverage or private insurance. When a family is paying for commercial home care out-of-pocket, it may go to a great deal of effort to minimize the cost. The family's interest in minimizing cost ebbs when a third party is paying the bill.

Thirdly, the cost of commercial home care will zoom in the future. Historically cost increases for home care services have been depressed because:

a. Our Medicaid system has driven care recipients to nursing homes by reimbursing nursing home expenses, but not home care expenses.
b. Our culture is still adapting to the concept of hiring someone to provide care to your family member. It will become an increasingly acceptable approach.
c. The home care delivery system may have grown in advance of the needs as entrepreneurs anticipated that home care would be in great demand.
d. The home care industry has been fractured, hence not run with fiscal acumen. Consolidation is likely to occur.
e. Inexpensive immigrant labor may have contributed to low costs.

Going forward, tremendous inflation is likely in the commercial home care industry because:

a. Commercial care will be come more "acceptable".
b. Commercial home care will become more fiscally-sound.
c. Demand will greatly exceed supply. While the number of elder people requiring care will

increase tremendously, the number of adult able-bodied providers might remain fairly stable.

d. Increasing numbers of younger adults will also be needing care as a result of increased survival by handicapped babies and children who would have succumbed in the past. Furthermore obesity, adult-onset and environmental issues could have a significant impact.

Some of the above factors may be partly offset by improved electronic caregiving capabilities. See the Urban Institute's May 2007 study entitled "Meeting the Long Term Care Needs of the Baby Boomers", for corroboratory analysis.

So, for the $75/day benefit to provide meaningful support, it will have to keep pace with the inflation in the cost of commercial home care services, which is likely to exceed the commonly-quoted Urban CPI.

This inflation aspect is an area in which well-intentioned projections as to the impact and cost of the CLASS Act might turn out to be seriously understated.

1. On a number of occasions, I've heard suggestions that the intent of the program is to "stimulate the private LTCi industry". The theory is that the availability and publicity of this program will help the private LTCi industry grow. Presuming that such statements are made in good faith, they reflect surprising naiveté.

   Private industry and the government have invested a lot of money, time and effort to educate the public that LTC needs are typically not covered by Medicare. Although we have had meaningful success, some people still don't understand. Private industry and the government plan substantial resource to continue such educational efforts.

In that light, can we reasonably expect that the institution of a government-provided LTC program through the CLASS Act will impact the public in any way other than to persuade them that the government will cover their LTC needs? Even if the program has shortcomings and knowledgeable people are aware of those shortcomings, they will project in their minds that, by the time they need care, the program will be more generous. They'll hope for such increase in benefits and defer a decision to buy private LTCi until they know what the government will do. Of course, the longer they defer, the less affordable the insurance. The result will be fewer sales of private LTCi.

Even some people who are not enrolled in the program will still think they are covered or will expect to be able to enroll whenever they may need care.

In such an environment, educating people about the nature of potential LTC needs far into the future will get more difficult. A (much) smaller percentage of people would buy coverage that would wrap around the CLASS Act coverage than would buy LTCi today, even though the premium for such coverage would be lower because CLASS Act benefits would be carved out. Indeed, the more valuable the $75 CLASS Act benefit, the more difficult to sell a meaningful wrap-around coverage.

Insurance brokers would need more revenue from a sale to fund the increased difficulty and time-consuming sales process. But such income would have to be spread across fewer sales and smaller sales. Hence the distribution cost of the product would increase significantly as a percentage of the premium. Clearly the impact on cost of the product is undesirable and damaging to the LTCi industry. Creation of a meaningful CLASS Act benefit seems likely to collapse the LTCi industry.

If the program is fine-tuned to reduce the percentage of people who will enrolled, in order to salvage some ground for the private LTCi industry, the results of the CLASS program will deteriorate. It needs a high percentage of participation to minimize anti-selection. That is, if fewer people enroll, those people will include those most likely to need LTC.

Realistically, the CLASS Act proposal will create two negatives: unfunded liabilities and a dismantled private LTCi industry. The relative degree of unfunded liabilities and a dismantled private LTCi industry will vary depending on the way the program is instituted and changes over time, but both of these negatives seems very likely to occur, in my opinion.

If this program is toned down to focus on the less affluent, we end up covering people who would be covered by Medicaid. What is the need to replace Medicaid as the provider of LTC services to the impoverished? The primary way the CLASS Act would reduce Medicaid expenditures is to transfer the expenses to another account. That does not constitute savings at all. I am submitting another paper regarding reducing Medicaid expenditures.

A few more observations that may be helpful:

a. The CLASS Act says that CLASS coverage would be treated like tax-qualified coverage from LTCi policies. That statement seems to apply to taxation of benefits. As regards taxation of premiums, the CLASS Act, as noted above, stipulates that the premiums would be tax-deductible. The CLASS Act does NOT stipulate that private LTCi premiums would be tax-deductible. If CLASS Act premiums are tax-deductible but private LTCi premiums are not tax-deductible, there would be unfair competition between the CLASS Act and private LTCi. How could the private industry compete?

b. There are additional costs in the CLASS Act proposal which might not have been reflected in the AAA analysis.

   --The beneficiary would also be entitled to advocacy, advice and assistance services from apparently a couple of counselors.

   --The bill also requires states to develop adequate caregiving services and creates a federal panel to study the adequacy of caregiver salaries. That might be an unfunded Federal mandate.

   --The higher benefits for needing help with 4 ADLs (activities of daily living) vs 2 ADLs adds cost to distinguish status. Benefit cost is also likely to increase with such a design, because families will want to show a 4-ADL need in order to double their benefits. This feature is another likely source of unintended benefit creep. In addition to claims of 4 ADLs, the government and public may realize that a 2-ADL need costs more than half of a 4-ADL need. Hence there may be pressure to increase the 2-ADL benefit level.

c. According to the CLASS Act, if someone is receiving Medicaid LTC benefits and is in a facility, that Medicaid beneficiary gets to keep 5% of her/his CLASS Act benefit in addition to their normal Personal Needs Allowance. In Missouri, for example, the Personal Needs Allowance is currently $30/month. With this provision, a person needing help with 2 ADLs might get to keep 5% of $75/day, which is 5% of $2250/month which is $112.50/month. The total becomes $142.50/month instead of $30/month. If the person needs help with 4 ADLs, it would become $265/month. That increase would add cost to the proposal.

d. A person on Medicaid Home Care could keep 50% of the LTCi benefit, depending on the state's Medicaid rules and services, but such money might have to be used for care purposes. Such a provision would increase benefit cost by increasing the amount of commercial home care utilized and would also increase processing costs.
e. CLASS benefits would be ignored when determining eligibility for other benefits. This provision either adds cost or forfeits a possible small offset to the costs of CLASS Act.

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