

The CLASS Act: What Employers Should Know

The Community Living Assistance Services and Supports Act ("CLASS Act"), is part of the healthcare reform legislation President Obama signed into law in March 2010. The CLASS Act, which will go into effect on January 1, 2011, will create a public insurance option that offers employees voluntary long term care ("LTC") insurance. According to the Act, the purpose of this title is to establish a national voluntary insurance program for purchasing community living assistance services and supports in order to:

- 1) Provide individuals who have functional limitations with tools that will allow them to maintain their personal and financial independence through a new financing strategy for community living assistance services and supports;*
- 2) Establish an infrastructure that will help address the nation's community living assistance services and support needs;*
- 3) Alleviate burdens on family caregivers; and*
- 4) Address institutional bias by providing a financing mechanism that supports personal choice and independence.*

Employers may (but are not required to) allow employees to make CLASS program contributions through payroll deduction with auto-enrollment. Moreover, employers may offer private long term care arrangements to employees in addition to the CLASS program or instead of the CLASS program. Employees whose employers do not offer the CLASS program may participate in the CLASS program through alternative payment methods established by the Secretary (the "Secretary") of the Department of Health and Human Services ("HHS"). The CLASS program is required to be self-supportive and prohibits any use of taxpayer money to fund benefit payments. The President will appoint an advisory board (the "Board"), whose goal is to manage the program so that it is self-supporting over a 75-year time horizon. If the Board determines the program is not actuarially sound, it must submit alternative recommendations for legislative action, including whether or not to adjust monthly premiums or impose a temporary moratorium on new enrollments.

Before embracing the government program, employers will need to answer a few key questions:

- What are the advantages and disadvantages of choosing the CLASS program or a private plan?*
- Is it practical for employers to simultaneously offer both the CLASS program and a private plan? If not, what is a better choice?*
- What are employees' potential perceptions? Which plan will offer them better value?*

Note: Because many of the details of the CLASS program have been delegated to the Secretary of HHS to develop, including the fundamental details of premium rates and benefit levels, this analysis cannot be conclusive until regulations or other guidance is issued.

Key Provisions of CLASS Act

- Premiums.** Monthly premiums will vary only by issue age (except for those who reenroll after having a lapse of longer than three months as described below) and are intended to be level for the life of the employee. Premiums and benefit levels/triggers will be set by the Secretary so that the program is actuarially sound over both the near term (over 20 years) and long term (over 75 years). The 75-year projection is to be prepared annually beginning January 1, 2014. Premiums may be increased, for both current participants in the program and new participants in the program, in order to protect the fund's future solvency. Seniors (over age 65 years old) who have paid

premiums for at least 20 years and are not actively employed are exempt from paying any premium increase. Low-income individuals (whose income does not exceed the poverty line) and full-time students up to age 22, need to pay only nominal premiums (capped at \$5 and adjusted for CPI). Monthly premiums will be deducted from the paychecks of employees whose employers offer the CLASS program. Other methods of paying premiums are to be established by the Secretary for individuals whose employers do not elect to offer the CLASS program.

- **Eligibility to Receive Benefits.** Benefits triggers under the CLASS program are similar to those under other federal tax qualified LTC programs. To receive benefits, participants must be unable to perform a specified number (either two or three, as determined by the Secretary) of Activities of Daily Living ("ADL"), or have an equivalent cognitive impairment, for a continuous period of more than 90 days. Individuals must pay premiums for five years, and must earn wages for at least three of those years before they can be eligible for CLASS benefits.
- **Enrollment & Disenrollment.** The CLASS program is designed to be a voluntary auto-enroll program. HHS may establish alternative enrollment procedures for those who are self-employed, employed by multiple employers, or whose employers do not elect to offer the CLASS program. Employees over age 18 are eligible to enroll in the CLASS program provided they are actively at work and receive income that is subject to social security tax.

Employees who do not enroll when initially eligible may subsequently enroll only during open enrollment periods established by the Secretary. Such open enrollment periods cannot be more than biennial. Employees who initially enroll in the program and later disenroll can reenroll without providing evidence of insurability. The Act allows disenrollment only during annual periods established by the Secretary. If the employee reenrolls after more than a three-month lapse in premium payments, the employee's premium will be recalculated based on the employee's attained age at time of reenrollment. If the employee reenrolls within five years, then the employee is entitled to a premium credit for previously paid premiums. For individuals who reenroll in the program after a five-year lapse, a late reenrollment penalty of no less than one percent of monthly premiums since disenrollment will be added to their attained age premium.

Observation: *Because an individual is automatically disenrolled if he or she fails to pay their CLASS premium, the employee would, in effect, have the option of disenrolling at any time, thus rendering the disenrollment period ineffective unless future regulations require the employer to continue to enforce payroll deductions. Note: An individual who does not participate continuously in the CLASS program but who periodically enrolls at least once every five years would avoid the reenrollment premium penalty. However, each time such individual experienced a lapse of more than three months, his or her premium would increase based on the individual's attained age at his or her reenrollment date.*

- **Benefits.** Beneficiaries will receive a cash benefit on a daily or weekly basis, based on a scale of functional ability. In addition, the benefits paid to all claimants will average no less than \$50 per day (adjusted annually for inflation). However, there is no lifetime or aggregate limit on benefit payments. Benefits may be paid into a Life Independence Account ("LIA") established by HHS for each eligible beneficiary. Benefits can be used to purchase non-medical services and maintain independence at home or in a community residential setting of choice.
- **Benefits Coordination.** The Act provides that CLASS benefits will be primary, and state Medicaid programs secondary, for beneficiaries enrolled in Medicaid. Fifty percent (if the beneficiary is receiving home and community-based services) or 95 percent (if the beneficiary is institutionalized) of the cash benefits received from CLASS will be used to reimburse state Medicaid agencies for providing Medicaid benefits. The CLASS benefits will not affect eligibility for other federal, state or local benefit programs.

How CLASS Differs from Group Long Term Care Plans

Employers who are considering or currently offer group long term care ("GLTC") to their employees should review the benefits and features of the CLASS program. The CLASS program may itself encourage some employers to consider offering a GLTC, even if they decide not to offer the CLASS program.

Observation: *It may be difficult for an employer to offer both a GLTC and the CLASS program. This is because the automatic enrollment feature of the CLASS plan may result in too low an enrollment in a GLTC plan for the GLTC plan to be viable. Furthermore, participating in long term care insurance is a complex decision, and offering employees two very different plans could make the decision even more so.*

In order to help employers determine their options, we have compared some of the features of the CLASS program to a typical GLTC plan, focusing on benefit adequacy and premium sustainability.

CLASS	Group Long-Term Care Plan	PwC Comment
Enrollment Process		
<p>Employers who offer CLASS auto-enroll employees through payroll deduction. This enrollment is a negative election and similar to how many 401(k) plans operate. The 401(k) experience has shown that a negative election feature is a very effective enrollment tool. Alternatively, individuals can enroll through procedures set up by HHS. If an individual does not enroll when first eligible, he/she must wait for the next open enrollment period. The Act states that the Secretary can declare periodic open enrollment periods, but they can occur no more frequently than every two years.</p>	<p>Employees usually enroll in the program (1) during the employer-established open enrollment period, (2) when the plan first goes into effect or (3) when the employee is hired. Employees may be permitted to enroll between open enrollment periods upon providing evidence of insurability.</p>	<p>The ability of employees to enroll when they are financially able to by submitting evidence of insurability may make a GLTC plan more flexible than the CLASS program from an enrollment perspective.</p>
Participation Rate		
<p>The CLASS program is expected to have a relatively high participation rate as a result of negative enrollment (e.g., employers auto-enroll employees and employees stay in the program unless they opt-out).</p>	<p>A positive enrollment feature for a private long-term care plan likely will result in a relatively low participation rate (e.g., employees need to opt in during the annual open enrollment period).</p>	<p>As mentioned previously, negative enrollment has proven to be extremely effective in boosting 401(k) plan participation. Enrollment in the CLASS program should prove to be significantly greater than enrollment in a typical GLTC plan.</p>
Underwriting and Vesting Period		
<p>No underwriting beyond an actively at work test is required; however a five-year vesting period (including three working years) is mandatory for benefit eligibility.</p>	<p>There is usually no or minimal underwriting to enroll when first eligible beyond an actively at work test. There might be additional underwriting requirements (e.g., medical records and other evidence of insurability) if enrollment occurs late. There is often no vesting period (i.e., participants are covered immediately).</p>	<p>CLASS relies on both a five-year vesting period and an actively at work test in order to reduce anti-selection to an acceptable level, while GLTC plans typically offer coverage immediately upon employee enrollment.</p>
Premium		
<p>Premium rates will be determined by HHS with subsidies for low-income individuals and students. As a self-funded program, premiums may be rescaled for future solvency considerations, though some seniors (over age 65) are exempted. Premium rates vary by issue age. The CLASS program contains an implicit redistribution tax to subsidize lower income and full-time student participants. CLASS cannot be funded directly by taxpayer funds, but has a guaranteed rate provision for those over age 65 who have participated for twenty years and are not actively at work. If future enrollment is insufficient, this could result in larger premium increases for the under age 65 population.</p>	<p>Premiums are priced according to benefit options (e.g., daily benefit amount) and other risk factors. There is no implicit premium subsidy for low-income individuals. Premium rates vary by issue age and marital status. GLTC plans are typically subject to commissions, profit charges and premium taxes.</p>	<p>There are numerous studies showing significantly lower long term care claim rates for married participants as opposed to singles. As group and individual LTC plans generally offer discounts to married individuals, it is possible that married employees may find private long term care plans cheaper than the CLASS program, while singles may find the CLASS program more economical. The ability of private plans to attract lower cost policyholders may put upward pressure on premium rates in the CLASS program because of the likelihood of higher claims rates from enrolled singles.</p>
Benefits Amounts		
<p>Benefits will vary by severity of functional limitation. However, the amount of benefits to be paid based on functional limitations is undefined, other than that the average (among all</p>	<p>Enrollees select contractually defined benefit amounts. A typical GLTC plan enables an employee to select benefit levels that are</p>	<p>If CLASS benefits do average \$50/day, then benefit amounts are very likely to be inadequate. This would require nominal payments to people with minor</p>

CLASS	Group Long-Term Care Plan	PwC Comment
<p>beneficiaries) will be no less than \$50 per day. The benefit schedule can be adjusted in future years by the Secretary; accordingly, there is uncertainty about actual benefit amounts.</p>	<p>commensurate with the cost of services.</p>	<p>functional limitations in order to disburse higher payments to people with greater needs. Nursing home and home health care costs for individuals with two or more ADL impairments typically run from \$150 to \$300 per day, depending on where care is delivered. The limited CLASS benefit amount could cause employees to believe they are adequately protected by the CLASS program, and therefore not pursue supplemental coverage. There is the potential for insurance companies to design a new supplemental product to wrap around the CLASS benefits to reach adequate coverage levels.</p> <p>Future changes in the benefit levels and triggers can enable the Secretary to keep the CLASS program in balance.</p>
Non-forfeiture Benefit		
<p>As passed, the Act seems to provide that an individual whose premiums have lapsed for more than five years (even if the lapse is due to a rate increase) not only receives no credit for previously paid premiums, but must also pay a penalty to reenroll.</p> <p>Note: Congress may not have intended to impose a double penalty (i.e., forfeiture and increased premiums) on reenrolling participants. This provision may be clarified in subsequent legislation or by regulation.</p>	<p>Non-forfeiture benefits in the event of a (usually nominal) rate increase have been a standard feature in most states.</p>	<p>A benefit bank, offered as a non-forfeiture benefit, under GLTC plans, in the event of a rate increase, compensates a policyholder who entered an agreement based on what he thought was an affordable premium but, as a result of premium increases, is no longer affordable.</p>
Benefit Payout		
<p>Benefits may be paid into a LIA, which HHS establishes for each eligible beneficiary. Some unique benefits (such as a living will and legal assistance) may be introduced in the LIA.</p>	<p>There is no LIA account. Benefits may be paid in an alternative method under an Alternative Method of Care Rider but this is at the discretion of the insurer.</p>	
Administrative Expense		
<p>The Act states that administrative expenses cannot exceed three percent of premium. Advocacy and assistance counseling services expenses are considered to be administrative expenses. However, the bill does not say if marketing, enrollment, and start-up expenses are part of this three percent.</p>	<p>The administrative expense (including premium tax) is generally around 15 percent* of premiums. Acquisition costs (mainly commissions) are additional costs and will represent a significant portion of first year expenses.</p> <p>* This is an estimate based on the experience of several large US LTC carriers in 2009.</p>	<p>A plan with only a three percent expense ratio would represent a significant competitive advantage that should benefit program participants. However, given that even the largest long term care writers have an expense ratio closer to 15 percent of premiums, there is a question as to whether the CLASS program can deliver adequate services at this expense level without government subsidization.</p> <p>It appears the Act's prohibition against taxpayer funds applies only to the payment of benefits under the program and not to marketing or administrative costs; therefore, it is not clear whether or not taxpayer funds can be used to pay the administrative expense charges.</p>

CLASS			Group Long-Term Care Plan	PwC Comment
Tax Treatment				
<p>Tax treatment is the same as for tax-qualified long-term care plans (i.e., benefits are non-taxable and premiums may be eligible for medical expense deduction).</p>	<p>A tax qualified long-term care plan (which requires two or three ADLs to trigger benefits) is the most common type of GLTC plan. Non-tax qualified LTC policies include a less strict benefit trigger, while their benefits are subject to income taxes.</p>			
Dependent Coverage				
<p>The CLASS program does not extend coverage to an employee's family members. It is not clear how non-working spouses can enroll in the program or receive benefits under it due to the requirement that the beneficiary must have had sufficient earning to be credited with a quarter of coverage under the Social Security Act.</p>	<p>Subject to evidence of insurability, GLTC plans usually allow family members (e.g., spouses) to access the LTC policies through the employee.</p>		<p>The inability of a non-working spouse to enroll in the CLASS program appears to be a potential deficiency.</p>	
Fund Management				
<p>The program will be funded through monthly collected premiums and investment income. As is the case with the Social Security Trust fund, premiums that are used to pay current year benefits will be held in a separate trust fund (Class Independence Fund). The funds can be invested only in the same manner and to the same extent as the Federal Supplementary Medical Insurance Trust Fund in accordance with the Social Security Act. This limits the program's investments to U.S. Government bonds* and precludes hedging against the risk that future investment income will be lower than was assumed in pricing the plan. Assuming all other items occur as expected, if actual investment earnings are lower than assumed investment earnings, then premiums would need to be increased for the program to remain solvent.</p> <p>*Details on fund investment restrictions can be found at "Compilation of Social Security Laws, Federal Supplementary Medical Insurance Trust Fund (Sec 1841), http://www.ssa.gov/OP_Home/ssact/title18/1841.htm"</p>	<p>The funds for most GLTC plans are co-mingled and managed as part of an insurance carrier's general account. Insurance carrier's investment limitations result from the insurance laws and regulations in the state of domicile. They tend to be significantly more flexible than what is permissible under the CLASS program, which enables carriers to develop an investment strategy that is appropriate to liabilities. A number of insurers have successfully used either the cash funding market or the swap market to hedge against the risk of investment earnings falling below pricing assumptions. This has provided a level of stability to premium rates when future investment earnings rates have been lower than prior assumptions.</p>		<p>Investment income is an important component in funding the benefits of a long term care insurance plan, and investment earnings fund a significant proportion of total benefits paid under a plan. For a typical plan with an issue age 65, a one percent change in future investment earnings has a 13 percent impact on the premium charged. The inability of CLASS to hedge future interest rate exposure could lead to volatility in premium rates if future investment earnings rates deviate from prior assumptions.</p>	

Conclusions

It is important for employers to carefully consider their options in providing long term care coverage to offer their employees. Key considerations will include benefit adequacy, premium stability, and potential service capability. Employers should consider the potential benefits and uncertainties of the CLASS program relative to more traditional group long term care plans or offering no long term care plan at all.

For more information on the topic discussed in this *HRS Insight* or to change your address, contact your local PricewaterhouseCoopers professional.

Atlanta, GA	Ann O'Connell	678-419-2820	Los Angeles, CA	Carrie Duarte	213-356-6396
	Charlie Yovino	678-419-1330	New York Metro	John Caplan	646-471-3646
Boston, MA	Ed Donovan	617-530-4722		Ed Donovan	646-471-8855
	Matthew Cowell	617-530-5694		Scott Olsen	646-471-0651
Charlotte, NC	Charlie Yovino	704-344-7739	Philadelphia, PA	Ted Volz	267-330-3180
Chicago, IL	Pat Meyer	312-298-6229		Bruce Clouser	267-330-3194
	Jack Abraham	312-298-2164		Bill Dunn	267-330-6105
	Paul Perry	312-298-3157	San Francisco, CA	Julie Rumberger	408-817-4460
	Terry Richardson	312-298-3717	San Jose, CA	Scott Pollak	408-817-7446
Dallas, TX	Charlie Wheeler	214-754-5023		Julie Rumberger	408-817-4460
Detroit, MI	Theresa Gee	312-298-4700	St. Louis, MO	Terry Richardson	312-298-3717
Houston, TX	Todd Hoffman	713-356-8440	Washington, DC	Jeff Davis	202-414-1857
Kansas City, MO	Terry Richardson	312-298-3717		Nik Shah	703-918-1208

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2010 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a Delaware limited liability partnership) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. *connectedthinking is a trademark of PricewaterhouseCoopers.