

**A REPORT ON THE ACTUARIAL,
MARKETING, AND LEGAL ANALYSES
OF THE CLASS PROGRAM**

APPENDIX O:

**ACTUARIAL REPORT ON THE DEVELOPMENT OF
CLASS BENEFIT PLANS**

Actuarial Report on the Development of CLASS Benefit Plans

for

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Purpose and Disclosure

This report describes our development of the proposed CLASS benefit plans in the Office of CLASS. It is written for the general audience with a basic knowledge of the CLASS Act¹.

The CLASS Office was given the task to develop benefit plan alternatives that are:

- Actuarially sound and sustainable over a 75-year period,
- Based on reasonable assumptions as certified by Chief Actuary of the Centers for Medicare & Medicaid Services,
- Legally permissible, and
- Marketable to a large number of employers and employees.

Provisions of the CLASS Act form the basis for development of the proposed benefit plans. We believe we have adhered to relevant professional actuarial guidelines and recommendations².

This report represents the contributions of its authors to plan development process as of its release date. Final proposed benefit plans may be different from the ones discussed here. We have sought guidance from experts in the CLASS Office. Interpretations and views expressed in this report are the professional opinions of its authors³ and may not be consistent with the opinions of the Office of CLASS, the Office of the General Counsel or the Department of Health and Human Services (HHS). Throughout this report, the word “we” refers to the authors of this report and no one else.

Reasons for CLASS

There is an unmet need to protect working Americans against the high costs⁴ of long-term

¹ The CLASS Act was enacted as Title VIII of the Patient Protection and Affordable Care Act, P.L. 111-148 (March 23, 2010), which amended the Public Health Service Act, 42 U.S.C. section 201 *et seq.*, by adding the CLASS Act as Title XXXII.

² They include: Actuarial Standards of Practice No. 12: *Risk Classification*, American Academy of Actuaries, updated May 2011, Actuarial Standards of Practice No. 18: *Long Term Care Insurance*, updated May 2011, and Health Practice Council Practice Note: *Long-Term Care Insurance*, August 2003.

³ As of the release date of this report, Gregory Kissel is on loan from the Office of Personnel Management on a part-time basis.

⁴ Current long-term care cost ranges from an average of approximately \$16,000 per year for home and community care (assuming 3 hours per day, 5 days a week) to \$70,000 for nursing home care – 2010 *Market Survey of Long-Term Care Costs*, MetLife Mature Market Institute.

care services⁵. Few of them have financial protection against the significant risk of eventually using the services⁶. This is especially true for workers with modest income who are vulnerable to become future Medicaid beneficiaries.

Insurers have been exiting or curtailing their long-term care insurance business. Recent development in the interest rate environment, accounting standards and regulation on the use of genetic information suggest a dim future. Well publicized significant premium increases have shaken consumers' confidence in the product. Currently only three major insurers⁷ are actively offering group long-term care insurance. Opportunity is therefore limited for working Americans in seeking cost-effective protection against the risk of high long-term care costs.

CLASS is designed to be a voluntary, affordable long-term care insurance program for the American workers. It will provide a modest level of benefits to help qualified beneficiaries to live independently in the community. Beneficiaries will have considerable freedom to dictate the appropriate services and supports for themselves. Benefits are paid entirely through enrollees' premiums without any taxpayer subsidy. Compared to private insurance, the CLASS Program has better transparency and accountability because of its certification process.

Long-term care is as much a problem for the young as it is a problem for the old. With most working Americans unprotected, Medicaid will continue to be the payer of last resort for their future long-term care services. This is an escalating burden particularly for our future generation of taxpayers who are becoming fewer in number compared to the older generation⁸. Enrollment in the CLASS Program could delay and reduce future dependence on Medicaid. Thus the CLASS Program promotes individual responsibility and less reliance on government for support.

The CLASS Program has the potential to have a seminal effect on long-term care financing in this country. It could significantly increase public awareness of the risk of long-term care. Future Medicaid spending could materially be reduced if more Americans seek insurance protection, whether through CLASS or the private market. Tight controls on Medicaid long-term care spending become more acceptable when programs such as CLASS are available as

⁵ Even though the CLASS Program emphasizes care in the community, benefits will be paid regardless of the setting. In this report, community care and long-term care have the same meaning.

⁶ Less than 8% of Americans under age 65 has private long-term care insurance – *Who Purchase Long Term Care Insurance?* Richard W. Johnson and Janice S. Park, Urban Institute, March, 2011. However, approximately 1 out of 2 persons over age 65 will need some *formal* care in the remaining lifetime. See *Long-Term Care Over an Uncertain Future: What can Current Retirees Expect?*, Peter Kemper, Harriet L. Komisar and Lisa Alecxih, Inquiry, Volume 42, Winter 2005/2006.

⁷ UNUM, Genworth Financial and Prudential Insurance Company.

⁸ Annual Medicaid long-term care spending is projected to grow from \$64 billion to \$101 billion in 2030 – Lewin Group, 2010, while the ratio of persons under 65 to persons 65 and over is 4.6 for 2010 and the corresponding projected ratio is 2.8 in 2030 – U.S. Census Bureau.

an alternative. The CLASS Program could be the catalyst for a much needed national aging policy to improve the quality of life for older Americans.

The CLASS Act Statute

Due to the lack of conference reports and other explanatory documents, we effectively relied only on the text of the statute for benefit plan design.

The following provisions in the statute have significant influence on benefit plan design:

1. The CLASS program is a voluntary insurance program⁹. An insurance program allows a group of individuals to share the risks by collecting premiums from everyone and paying benefits only to those for whom the risk materializes. An insurance program operates under the law of large numbers. That is, the individuals in the program form a sufficiently large homogeneous group with relatively the same risk so that the actual claim results will be close to that assumed in the premiums. In a voluntary insurance program, the group must be relatively free of asymmetric information where certain insureds have better information about their risk of claiming benefits than the insurer. Otherwise, premiums will be high and unattractive to lower risk individuals. This situation would render the program unworkable.
2. Actuarial soundness is mentioned in at least in four occasions¹⁰. Adapting from a number of sources¹¹, we have developed the following working definition for the CLASS Program:

A CLASS benefit plan is actuarially sound if, at any time, the balance on the trust fund, all future anticipated premiums and investment income, in aggregate, are adequate to provide for all reasonable and appropriate anticipated future costs, including plan benefits, benefit-related expenses, marketing and administrative expenses.

Several comments regarding this definition:

- a. Actuarial soundness is a prospective determination of projected income covering projected outgo with a certain comfort level.

⁹ CLASS Act, Sec. 3201.

¹⁰ CLASS Act, Sec. 3203(a)(1), Sec. 3203(a)(2)(B), Sec. 3203(b)(1)(E)(i), Sec. 3206(b)(2)(A)(iii).

¹¹ Actuarial Standards of Practice No. 26: Compliance with Statutory and Regulatory Requirements for the Actuarial Certification of Small Employer Health Benefit Plans, May 2011 and Health Practice Council Practice Note: Actuarial Certification of Rates for Medicaid Managed Care Programs, August 2005.

- b. This definition implicitly satisfies the stipulation that no public funds can be used to pay CLASS benefits¹².
- c. An actuarially sound benefit plan encompasses not only the benefit design that makes it sound but also other rules of the plan that serve to minimize moral hazard¹³. These rules affect the procedures for enrollment and reenrollment, conditions for enrollment and benefits, etc.

The statute also requires the CLASS Program be sustainable over a 75-year period such that there will be sufficient funds to pay future benefits. A plan that is deemed actuarially sound would provide good assurance (though not absolute guarantees since future events are uncertain) that the Program is sustainable. On the other hand, a program where the projected income barely covers the projected expenses may be sustainable but it is not actuarially sound because there is insufficient margin for future unfavorable experience.

- 3. The CLASS Independence Advisory Council will recommend a benefit plan for designation as the CLASS Independence Benefit Plan that “best *balances price and benefits* while *optimizing the probability of long-term sustainability* of the Program”¹⁴ (emphasis added). These two phrases epitomized the value proposition of CLASS to the American workers. In order for the Plan to be attractive to the consumers, it needs to be competitive with private insurance. Ensuring long-term sustainability will result in stable premiums for the enrollees.
- 4. While the statute prescribes certain conditions and restrictions, in no way does it define a specific plan. In fact, the statute requires at least 3 actuarially sound plan choices for consideration¹⁵. The statute thus anticipates alternative plan designs to be developed within its confine. Being actuarially sound does not satisfy all of the design goals. The designated plan still needs to be attractive to the consumers.

¹² CLASS Act, Sec. 3208(b).

¹³ In insurance, moral hazard occurs when certain insured’s behavior results in unfavorable overall experience for the insurance program. For example, spend more insurance benefits than reasonably needed if they have to be paid out-of-pocket.

¹⁴ CLASS Act, Sec. 3203(a)(2)(B).

¹⁵ CLASS Act, Sec. 3202(a)(1).

5. No underwriting can be used to determine premiums or to prevent enrollment¹⁶. Taken together with the voluntary nature of the Program, this restriction poses potential adverse selection risk.
6. The Secretary is authorized to set premiums, designate the benefit plan and promulgate regulations regarding enrollment, benefit eligibility, claim payment, etc.

Implementing the statute involves interpretations that may be subject to challenges. Certain provisions in the statute appear to be in conflict with each other, specifically, with the premise of voluntary insurance. We discuss this further in the section below on Adverse Selection.

What CLASS Is Not

The statute explicitly contemplates an actuarially sound plan that “maximizes the probability of long-term sustainability”. Thus it would appear that, if a designated plan exists at all, it will unlikely be an entitlement program.

Similar to social insurance such as Social Security and Medicare, the CLASS Program is administered by the federal government, the benefits and eligibility criteria are established by statute, the accounting of income and expenses is through a trust fund (CLASS Independence Fund) and premiums are paid by the participants. Nevertheless, major distinctions exist between social insurance and the CLASS Program. Participation in social insurance is either compulsory or it is heavily subsidized so that the majority of eligible individuals choose to participate. Social insurance is generally not fully funded in that monies are not set aside to ensure that all future promises will be met. CLASS is voluntary and the majority of the eligible workers are not expected to enroll. It is fully funded by premiums collected from the enrollees, except for the initial program start-up costs.

In certain aspects, CLASS is closer to private insurance than social insurance. Both private insurance and CLASS are fully funded by premiums. Both call for margins in the premiums to protect from a certain level of unfavorable experience¹⁷. The CLASS trust fund acts like a reserve fund for private insurance; both funds are backed by the credit-worthiness of the insuring entities.

In order to be competitive with private insurance, one perceived gap between CLASS and private long-term care insurance may need to be narrowed. That is, benefits in private

¹⁶ CLASS Act, Sec. 3203(b)(3).

¹⁷ Actuarial soundness for the CLASS plans suggests a margin for unfavorable experience built into the premiums, similar to the specific margin for adverse experience required in long-term care insurance since 2003.

insurance are contractual; they can be altered only if the insurer is insolvent. This is not the case in the CLASS Program. However, we believe a hierarchy could possibly be established to adjust premiums and other factors first before adjusting benefits.

Adverse Selection

A precept of the statute is that no underwriting, other than age, can be used to set premiums or prevent enrollment into the Program. Because the CLASS Program is voluntary, there is a strong potential for the Program to attract a disproportionate number of high risk workers who are likely to need long-term care services. This adverse selection violates the principle for a sound insurance program. Private long-term care insurance generally requires underwriting and therefore can expect to have lower claim costs than that for the CLASS Program. Other things being equal, CLASS premiums may have to be considerably higher than the premiums for private insurance.

If CLASS premiums are uncompetitive against private insurance’s premiums, healthy workers who can meet underwriting requirements would likely pick private insurance over the CLASS Program. As well, employers have a fiduciary responsibility to look out for the best interest of their employees. They would also decline to offer CLASS if the premiums are too high. This exacerbates the problem of a higher than expected concentration of unhealthy enrollees. There may also be organized efforts to encourage workers with functional limitations to enroll. All these factors make it very difficult to determine the correct premiums.

The following simple example illustrates the challenge in such a situation. Suppose there is a 10% chance for a normal worker to have a toothache during a single year. An insurance plan will pay \$1,000 if the participants have a toothache. This plan is offered on a voluntary basis to a group of workers in which 5 of them already had a toothache. Suppose there are only 6 workers enrolled. Ignoring expenses, the range of possible premiums that are expected to be sufficient to meet the benefit obligation is as follow:

Number of Workers with Toothache Enrolled	Premium
0	$(5 \times .10\% \times \$1,000) \div 6 = \83
1	$(1 + 5 \times 10\%) \times \$1,000 \div 6 = \$250$
2	$(2 + 4 \times 10\%) \times \$1,000 \div 6 = \$400$
3	$(3 + 3 \times 10\%) \times \$1,000 \div 6 = \$550$
4	$(4 + 2 \times 10\%) \times \$1,000 \div 6 = \$700$
5	$(5 + 1 \times 10\%) \times \$1,000 \div 6 = \$850$

Estimating premiums with this high level of variability is akin to gambling with the enrollees' funds; gambling is clearly not the role of the insuring entity.

Initial premiums will likely be inadequate if the enrollment of healthy workers turns out to be lower than was assumed in the pricing. Subsequent premiums would need to increase. This action would tend to drive out the healthy enrollees who can get lower premiums through private insurance. With fewer healthy enrollees, there may be more premium increases. This rate spiral can lead to program insolvency. Because of the potential for adverse selection, a number of experts have opined that the CLASS Program is unworkable.

In order to compete with private group long-term care insurance for enrollment, CLASS premiums need to be on par with the premiums for private insurance. Group long-term care insurance generally has a 65% loss ratio. That is, the present value of future benefits is projected to be 65% of the present value of future premiums¹⁸. The balance of 35% is essentially earmarked for profits and expenses. A realistic and reasonable projected loss ratio for the CLASS Benefit Plan is 80%¹⁹. If the CLASS premiums for the CLASS plan exactly matched private group long term care insurance's premiums for identical features and benefits, the CLASS Program will have an approximately 23% ($80\% \div 65\% - 1$) claim allowance over private insurance that can be used to account for the adverse selection effect. The challenge is to control the impact of adverse selection within this allowance²⁰.

Without any mitigation for adverse selection, premiums for an actuarially sound CLASS plan will need to anticipate that virtually every enrollee will qualify for benefits shortly after the 5 year vesting period. Thus the premiums will be set to pre-pay the benefits²¹. This scenario produces an estimated \$3,000 monthly premium²². The Program will be sustainable even with a very small number of enrollees. Of course, there is virtually no market for it.

Thus, without control for adverse selection, there is little chance for success.

¹⁸ The discount rate equals to a fixed interest rate used for statutory reserving.

¹⁹ This assumes a 20% expense ratio for CLASS. See later section for a discussion on expenses.

²⁰ We recognize that certain enrollees' attributes may partially offset the effect of asymmetric information. For example, risk-averse individuals tend to be attracted to insurance and are healthy. However, this attribute is already embedded in private insurance's experience. See *Multiple Dimensions of Private Information: Evidence from the Long-Term Care Insurance Market*, Amy Finkelstein and Kathleen McGarry, *American Economic Review*, September 2006.

²¹ In the toothache insurance example, this is analogous to charging \$1,000 premium. Because the expected number of claims is highly dependent on the number of enrolled workers who already had a toothache, we suggest that this is the only prudent premium that ensures a high likelihood of program sustainability.

²² See *Adverse Selection*, Memo to Kathy Greenlee from Bob Yee, April 27, 2011 (Attachment 1).

Plan Designs

At the beginning of the development process, we endeavored to generate a list of all possible designs we could think of. We ranked them into 3 groups:

- those that do not address adverse selection and have no market appeal,
- those that address adverse selection but have no market appeal, and
- those that have both²³.

From the last group, we refined the concepts and came up with the following plan designs. They are presented from an actuarial, not legal, perspective.

Phased Enrollment

Before discussing Phased Enrollment, it is helpful to review the types of risk mitigation practices typically used in the group long-term care insurance market. Insurers offer group coverage in the workplace with endorsement from the employers. Premiums are usually collected through payroll deduction. For large employee groups of over 500, insurers would generally offer guaranteed issue to full-time active workers during a limited enrollment period (1-2 months). Some form of underwriting is required for those enrolled outside of this period and for spouses and other immediate family members. New hires can enroll without underwriting during a short period following hire. Presumably, insurers are protected by the very limited window of opportunity for enrollment as opposed to a situation where the workers can join whenever it is to their advantage²⁴. Enrollees tend to be white-collared workers who have available discretionary income for insurance and who are generally in better health status than the average worker. To date, premium rate increase filings for group long-term care insurance are uncommon. The overall claim experience appears to be close to the anticipated claim costs in the development of the premiums.

The statute specifies two methods for workers to voluntarily enroll. Workers can enroll either through their participating employers or through an alternative individual method. Individual enrollment is for the self-employed, individuals with more than one employer, and for those workers whose employers are not participating in the Program. The statute is silent regarding the manner and timing for implementing either method.

²³ See Design Alternatives, May 6, 2011 (Attachment 2).

²⁴ Clearly high risk employees can still select against the insurance plans even with a short enrollment period. Although one insurer no longer in the group business is in the process of filing for premium increase, the overall experience to date suggests that this adverse effect from group enrollment is manageable and insurers have adjusted their claim expectation accordingly.

The Phased Enrollment design adopts certain risk mitigating practices from group long-term care insurance. Under this design, enrollments will be phased according to a pre-determined risk tolerance. Initial enrollments will first be limited to the group setting through employers with a specified minimum number of employees. The initial enrollment period will be 1 to 2 months. Subsequent enrollment periods will be indeterminate. This is similar to the current practice for guaranteed issue group long-term care insurance.

Such practice is workable in mitigating adverse selection because:

1. High risk workers cannot seek insurance. Only those whose employers participate can enroll.
2. Enrollment period is short. There is little opportunity for a working individual becoming unhealthy to enroll at will.
3. The relatively large size of the groups provides a spread of risk.

The alternative individual enrollment method allows any workers not included in group enrollments to sign up. Without a way to temper high risk workers to enroll as in the case for group enrollment, we expect most of adverse selection to come through this method. Accordingly, individual enrollment will commence in a controlled manner to ensure solvency of the Program.

Premiums will be set with a specific margin that provides for a reasonable allowance for individual enrollment in the future. The annually required actuarial analysis²⁵ will specify the number of future individual enrollments.

The following is an example of how Phased Enrollment works. A 20% load is added to the premiums for CLASS specifically for expected higher claims through individual enrollments. Suppose we determined that enrollees from individual enrollment can be expected to be 5 times more likely to claim than those through group enrollment²⁶. When the number of enrollees reaches 200,000 and provided that the claim assumption remains unchanged, we would allow up to 10,000 (= 200,000 x 20%/400%) new enrollees through individual enrollment.

Thus, under the Phased Enrollment design, the degree of adverse selection is rationed based on what is available to accommodate the expected higher claims. Individual enrollment starts when the group enrollment meets a pre-set threshold. We will allow a pre-

²⁵ CLASS Act, Sec. 3206(c)(2)(B)(i)(III - IV).

²⁶ Thus individual enrollment would have 400% extra claims than group enrollment. The initial estimation of expected increase in claim costs can be quantified through a study of disability status of individuals declined for private long-term care insurance.

determined number of workers to enroll during a limited individual enrollment period. In order to validate the adverse selection assumption, we plan to evaluate individual enrollees' medical records but naturally would not use them to deny enrollment. Lessons learned from the evaluation will help us to devise subsequent individual enrollments, including enrollments of employees from smaller sized employers.

The advantage of this design is that the impact of adverse selection is controlled. Note that this design does not materially alter our expectation of the ultimate number of enrollees in the CLASS Program since we expect that the majority of enrollees would come from group enrollment anyway. Phased Enrollment therefore does not mean the CLASS Program will necessarily be small. The disadvantage is that the margins designated for individual enrollments could be depleted due to overall unfavorable experience of the Program. The timing and the allotted number of individual enrollments are not guaranteed. There may be public pressure to expand individual enrollments thus causing harm to the Program. Finally, additional legal analysis will be required to determine whether the Phased Enrollment plan must be available to all employers.

Temporary Exclusion

This design aims to control the impact of adverse selection through the claim process rather than the enrollment process. Under this design, no benefits will be paid during the first 15 years²⁷ of an individual's enrollment if the qualifying ADL (Activities of Daily Living) or cognitive deficiencies can be determined to be the result of a prevailing serious medical condition that existed at the time of enrollment. At the time of enrollment, the enrollees will have access to a list of such conditions and acknowledge that they understand this restriction, if applicable. This list would be similar to the list of uninsurable conditions in private insurance's field underwriting manual. We will not collect medical information at time of enrollment. At time of claim, medical records will be reviewed to determine whether a serious medical condition existed at enrollment caused the deficiencies. If no determination can be made, or medical records are not available, we will pay the claim. From experience of the private group market, we expect that the majority of the enrollees will be relatively young (in their 40s). Because of this expectation, we believe the vast majority of beneficiaries with functional limitations during the first 15 years of their enrollment will have a medical origin, rather than due to frailty.

Qualifying deficiencies due to conditions not on the list or conditions developed after enrollment are eligible for benefits after the 5 year vesting period, assuming other benefit eligibility requirements have been met. This design puts the high risk enrollees on equal footing with the other enrollees, enabling the law of large numbers to work.

²⁷ Depending on the cost estimates for this provision, the 15 years may have to extend to 20 years in order to keep the CLASS premiums competitive.

Temporary exclusion is a risk mitigating technique used in life and disability insurance. We expect claims under this design to be estimable even though they would still be higher than claims from guaranteed issue group plans.

The advantage of this design is that all workers are treated fairly under the principle that enrollees insure only their unknown risk. The degree of subsidization among the workers is expected to be acceptable. The disadvantage is that this design could be perceived as a pre-existing condition exclusion where the insured is denied coverage or permanently excluded from claiming under the condition. Covering pre-existing conditions is possibly workable in an insurance program where there is substantial participation (for example, over 80%) to spread the extra risk. It violates the insurance principle of homogeneity of the insured group in programs such as CLASS where participation is expected to be low (typically less than 10%)²⁸.

Limited Initial Benefits

This plan pays a low benefit (for example, \$5 daily) if claimed during the first 20 years and a regular benefit (for example, \$50 daily benefit, indexed) otherwise. Because the benefit in the early years is quite low relative to the premiums, the Program may be less attractive to the high risk workers. Thus this approach can moderate adverse selection. The disadvantage of this design is that it may also be unattractive to the healthy workers, especially older workers who, as a whole, are closer to claim.

Scheduled Increasing Benefits

This design is similar to the Limited Initial Benefits. If the enrollee qualifies for benefits, it pays a \$20 daily benefit if claimed during the 6th year of enrollment. The \$20 daily benefit increases by \$6.50 each year of enrollment to an ultimate of \$150 at the 26th year and thereafter. The benefit will pay for a maximum of 36 months only. The intent is to discourage high risk individuals to enroll given the relatively low benefits in the early years. In order to comply with the statute, we believe the potential enrollees must choose between this design and the pre-paid plan as described in the Adverse Selection section.

In order to attract workers who desire a richer benefit, this design can work in conjunction with a private insurance offering. Together with coverage from the private plan, the total benefits of the package will pay a level \$150 from the first year of enrollment. Thus the private plan will provide coverage during the vesting period of the CLASS plan and the coverage will decrease each year to no coverage after 25 years of enrollment. To provide

²⁸ In the toothache insurance example, a high participation rate helps to keep the premium relatively reasonable. If 80 workers (including all 5 workers already had a toothache) enrolled, the premium of \$156 $[(5 + 75 \times 10\%) \times \$1,000 \div 80]$ is a more tolerable and predictable premium compared with the prospect if only 6 workers enrolled.

inflation protection, all daily benefits described for this design will increase by 3% each enrollment year.

The advantage of this design is that the effect of adverse selection is controlled to a certain degree but not eliminated. To be actuarially sound, this design will probably be more expensive than private insurance. It will be a challenge to compete with the more straightforward \$150 daily benefit private insurance plan. Another disadvantage is the complexity of the benefit schedule and the offering the pre-paid plan as well as the private insurance supplemental plan.

Actuarially Sound Plans

The above plan designs are not mutually exclusive. A plan combining these concepts can address the shortcomings of the individual design. According to the statute, the Secretary will present at least 3 actuarially sound plans to the CLASS Independence Advisory Council for review. The Council will recommend one of them to the Secretary for designation as the CLASS Independence Benefit Plan. For consideration, we propose the following 6 candidates for actuarially sound plans²⁹, some of which are combinations of the plan designs presented above:

1. Phased Enrollment as described above.
2. Phased Enrollment with Temporary Exclusion for individual enrollment.
3. Phased Enrollment with Limited Initial Benefit for individual enrollment.
4. Temporary Exclusion as described above.
5. Scheduled Increasing Benefits as described above.
6. Pre-paid plan as described in the Adverse Selection section.

This proposal is tentative since we have not yet completed our plan development process which will include final premium determination and further legal clearance.

In order to ensure success of the CLASS Program, all designs will also need to pass the marketability criterion. For example, the pre-paid plan assumes that there is no barrier to prevent or discourage who might be attracted to the program. Such a plan can be made actuarially sound if we assume that virtually everyone enrolled will claim. Thus the premiums (estimated to be \$3,000 per month) become that of a pre-paid arrangement. There will obviously be few enrollees.

²⁹ See Attachment 3 for a summary of the proposed plans.

Premium Illustration

The first 5 proposed plans are designed to mitigate the risk for adverse selection to a certain extent. Premiums for some of these plans can be made competitive with private insurance because the expense and profit savings could partially offset the anticipated extra claims.

Using comparable plan features, the following preliminary comparison illustrates the pricing position specifically of the Phased Enrollment plan relative to the offerings from three current group insurers³⁰:

Monthly Premium Illustration				
\$50 Initial Daily Benefit - 5 Year Benefit Period - 30 Day Elimination Period				
3% Annual Benefit Increase ^a				
	Prudential^b	UNUM^b	Genworth	CLASS^c
	Level Premium	Level Premium	Level Premium	Initial Premium
25	\$37	\$38	\$41	\$32
30	\$37	\$38	\$43	\$35
35	\$41	\$45	\$45	\$39
40	\$44	\$51	\$46	\$42
45	\$56	\$57	\$46	\$46
50	\$70	\$68	\$51	\$55
55	\$81	\$85	\$61	\$72
60	\$107	\$119	\$88	\$116
65	\$139	\$156	\$122	\$181
70	\$195	\$223	\$196	\$334 ^d

Note:

- a. Assumed long term CPI average
- b. i. Estimates of currently unavailable 3% inflation protection option
ii. Rate revisions pending due to low investment returns
- c. i. Estimated premiums, 4% annual premium increase to age 70 & level thereafter
ii. \$50 initial daily benefit for 2-3 ADLs, \$60 for 4+ ADLs & cognitive impairment
iii. 100% of daily benefit for 5 benefit years, 20% thereafter
- d. Level premium

³⁰ The purpose of this comparison is to merely illustrate the possibility of developing a CLASS plan that is reasonably price competitive with private group insurance. The CLASS premiums have not been finalized. Note in particular that the comparison is between the level premiums of private group insurance plans and the initial premium for the CLASS plan with an increasing premium schedule. In addition, this premium illustration is not derived from models provided by Actuarial Research Corporation and Avalere Health as described in the Actuarial Modeling section below.

The CLASS premium estimates for the Phased Enrollment design above are derived from Genworth's net premium rates (net of anticipated expenses and profits) adjusted for:

- CLASS-specific expenses,
- a loading for adverse selection from individual enrollment,
- a margin for unfavorable experience, and
- an increasing premium methodology (see Increasing Premium section below).

Genworth's rates are chosen because we believe that the associated pricing morbidity, mortality, lapse and investment assumptions are the most current among the three insurers. It is important to recognize that these are preliminary illustrations of premiums, not final pricing. As noted in the Next Steps section, premium estimation needs to be further refined with experience claim data, among other steps.

Since the Phased Enrollment process is similar to the enrollment process for guaranteed issue group plans, we expect that claim assumptions for the CLASS plans to closely reflect the claim experience of that segment of the private group market. As discussed earlier, residual effect of adverse selection from private insurance's guaranteed issued group enrollment is already embedded in group long-term care insurance's claim experience and their premiums. There are approximately 1.5 million certificates of group long-term care insurance currently in force. A survey is underway to collect recent claim assumptions for guaranteed issue group plans from six insurers that have group in-force business. This data source can provide considerable confidence in setting claim assumptions for a number of the proposed CLASS plans.

Summary on Plan Design

Having a competitive CLASS plan also creates an incentive for private insurance to work side-by-side, rather than directly compete, with the CLASS Program. Co-marketing with insurers (discussed below in Marketing Considerations section) should reach more workers and provide a better spread of risk.

The proposed plans provide a potential array of choices to achieve the goals set forth in the statute: "balance price and benefits while optimizing the probability of long-term sustainability of the Program"³¹. As will be covered in the following section, besides adverse selection, other issues need to be addressed such that the proposed plans are competitive and relatively free from moral hazard.

³¹ CLASS Act, Sec. 3203(a)(2)(B).

Other Design Issues

Daily Benefit Amounts and Triggers

At least two and up to six levels of benefits are required for the CLASS plan³². We propose two levels of benefits:

- \$50 initial daily benefit at 2-3 ADL deficiencies
- \$60 initial daily benefit at 4+ ADL deficiencies or cognitive impairment.

The amounts are chosen to discourage beneficiaries from claiming a higher level of disability than is warranted.

After the first year of an individual's enrollment, the daily benefit will increase according to the increase in the Consumer Price Index for Urban Consumers (CPI-U, or simply CPI). This is more generous than the required benefit increase in the statute. One potential interpretation of the statutory language is that the increase in the benefit amount begins only when a beneficiary receiving benefits (that is, everyone who claims starts with a \$50 daily benefit). Another potential interpretation is that the increase in the benefit amount starts from the 6th year of the CLASS Program. Note that increases in long-term care service costs have been historically higher than the CPI³³. While this proposed benefit indexing method may not cover future inflation increases fully, it does help to keep the premiums affordable.

In addition to the ADL and cognitive impairment triggers, the Secretary is authorized to define another similar benefit eligibility trigger³⁴. A possible third trigger would be one for mental illness. We believe the cognitive trigger already accommodates beneficiaries with mental retardation and some people with intellectual disability. As well, there is no established test similar to the standardized tests for cognitive impairment. A standardized test with sufficient experience data is a highly desirable for estimating claim incidence rates in an insurance setting. Adding this third trigger at this time will make the CLASS Benefit Plan more expensive and increase the likelihood of inadequate premiums for the Program. If the Program shows favorable results, we should revisit this issue.

Reduced Benefit Amounts

According to the statute, benefits are "not subject to any lifetime or aggregate limit."³⁵ As private insurance has painfully learned, because beneficiaries have no incentive to preserve

³² CLASS Act, Sec. 3203(a)(1)(D)(ii).

³³ U.S. Consumer Price Index for Urban Nursing Home and Urban Adult Day Care Costs, National Care Planning Council, http://www.longtermcarelink.net/eldercare/ref_cpi_inflation_rate.htm.

³⁴ CLASS Act, Sec. 3203(a)(1)(C)(iii).

³⁵ CLASS Act, Sec. 3203(a)(1)(D)(iv).

their benefits when there is no lifetime limit, unlimited benefit plans are expensive and risky. Most policies with lifetime benefits had significantly unfavorable experience. Premiums for lifetime benefits can be more than 50% higher than the corresponding premiums for a limited benefit period plan. The vast majority of group long-term care insurance policies today have a limited benefit period.

Our recommendation is to satisfy the statute by paying 100% of the daily benefit for the first five years and then only 20% thereafter, without limiting the aggregate amount or duration. This feature is intended to meet the requirements in the statute, keep CLASS premiums reasonably close to that for private insurance, and minimize one potential source for claim variability.

Cash Benefits

With regard to the form of benefits for the eligible beneficiaries, the statute states the following (emphasis added): “Cash benefits paid into a Life Independence Account of an eligible beneficiary shall be used to *purchase nonmedical services and supports* that the beneficiary *needs* to maintain his or her *independence* at home or in another residential setting of their choice in the community . . .”³⁶. Accordingly, we question whether payments of straight cash are required. Instead, cash equivalents in individual accounts could be used to purchase services and supports for the beneficiaries. The provisions of the statute appear to grant a great degree of autonomy to the beneficiaries on the choice and specifics of the services and supports.

We are not opposed to paying cash when it is appropriate. We believe it is difficult to determine whether it is appropriate or not. Sound insurance systems require a demonstration of a real loss. With cash payments as benefits without limitations, the enrollees are incited to claim whether there is a real loss or not. Unfortunately, we believe the statute gives conflicting messages regarding benefits. On one hand, it appears to limit the usage of the benefits. On the other hand, it appears to suggest cash payments without accounting for its use.

We utilized some of the learning from Cash and Counseling demonstration projects in the following proposed benefit structure. A counselor will be assigned to provide advice and assistance in planning of services and support, in particular, assistance in developing a plan of care. The cost of counseling will be part of claim administrative expenses and will not reduce the benefit amounts. Funds will be deposited into an individual account (the Life Independence Account) of the beneficiary on a weekly basis. Under the plan of care and the advice of the counselor, the beneficiary can direct available funds in the account to obtain the services and supports needed as long as they are not on a list of exclusions. This list would include items such as food, rent, liquor and luxury items. Within guidelines set by the CLASS Office, the counselor can make exceptions to the list. Associated with the account,

³⁶ CLASS Act, Sec. 3205(c)(1)(B).

the beneficiary will receive a debit card with which permissible services and supports can be purchased. Cash could not be withdrawn from the account via the debit card.

The CLASS Office will establish a process to train, monitor and evaluate the performance of the counselors. If beneficiaries need direct-paid care services (for example, unlicensed home health aide), they must use a fiscal manager to handle various employment and reporting requirements. The expenses associated with the fiscal manager will be deducted from the account balance. Specific activities and time spent by the paid direct care worker (including paid family members) must be fully documented.

Our goal is to strike a balance between beneficiary-directed benefits and the potential for induced demand from the perception of a free-flow of cash. According to the statute, “nothing in this title shall be construed as prohibiting benefits paid under the CLASS Independence Benefit Plan from being used to compensate a family caregiver. . .”³⁷ We remain concerned regarding unwarranted payments to family members, in particular, the spouse. It is difficult to differentiate spouse’s free time from the time spent that needs to be compensated. Moreover, payments to a spouse are effectively cash to the beneficiaries. We are considering a reduced payment amount to a spouse (for example, \$10 daily).

Regardless of our concerns, the proposed benefit structure is a significant departure from typical long-term care insurance benefits and should be viewed as an attractive feature of the CLASS plan.

Increasing Premiums

Long-term care insurance claim patterns are typically characterized by very few claims in the early years of a program and a significantly higher number of claims in the later years. Level premiums develop a relatively high fund balance in the early years when premiums exceed claims and expenses. This relationship reverses in later years.

For the CLASS Program, an increasing premium schedule provides several advantages:

1. Increasing premiums make the initial premiums lower than the corresponding level premiums. This may result in higher enrollments. This, in turn, increases the spread of risk and improves the chance for program sustainability.
2. An increasing premium plan provides less inflow to the trust fund in the early years than a level premium plan. The Program is subjected to less investment risk in matching the cash flow from assets with the cash flow from claim and expense obligations. Lower cash inflow also places less reliance on the expected relatively moderate fund returns available to the CLASS Program which is limited to an investment portfolio of Treasury Securities.

³⁷ CLASS Act, Sec. 3205(g).

3. As increasing premium schedules are still uncommon in private insurance, they could give the CLASS Program a temporary competitive advantage.

From the enrollees' perspective, an increasing premium schedule starts out significantly lower than the corresponding level premium but eventually exceeds it in later years. Lower initial premiums mean more efficient use of enrollees' discretionary dollars. Premiums go up relatively in line with increases in plan benefits and general wages. Also, if enrollees decide to lapse, their cumulative outlays would be less than their cumulative outlays for level premiums for the same period of coverage. However, a potential disadvantage of an increasing premium schedule is that enrollees may not be able to afford the premiums in their later years when the enrollees' income is relatively fixed. This can be addressed by exempting enrollees from scheduled premium increases after a certain age or period of enrollment.

One method of implementing an increasing premium schedule is to index the premium by the CPI in the same manner as the daily benefit amount increases by the index. This has the undesirable feature of ever-increasing premiums beyond the retirement years. Also, there will be uncertainty each year regarding the amounts of future increases.

We propose an increasing premium schedule with a 4% compounded annual increase that stops at age 70 (or after 5 years of enrollment, whichever is later). Premiums are level thereafter³⁸. The 4% is chosen to provide an attractive entry price point to most enrollees. Other increasing premium schedules, such as indexing up to a specific age, are also under consideration.

After enrollment, if an enrollee finds the increasing premium schedule unaffordable, the enrollee will have the option to freeze future premium increases with a corresponding freeze in benefits. However, if premiums need to increase for other reasons (not related to the set annual increase), enrollees who have frozen their premiums will still be subject to those increases.

Other Plan Features

Waiver of premiums during the time a beneficiary is receiving benefits is not a statutory requirement but is common in private long-term care insurance. To be competitive, the CLASS plan should also include this feature, except when the Limited Initial Benefit provision applies.

Premium discount for spouse coverage is also common in private insurance in recognition that couples tend to have lower claim costs than singles. However, we believe that premiums can only vary by the age at enrollment in CLASS. A response to the premium

³⁸ The entire schedule can move up or down according to experience of the program.

discount would be to allow a couple to share their benefits. If a spouse is a beneficiary for more than 5 years, the benefit amounts would not be reduced (that is, to 20%) to the extent that the other spouse's 5 year period has not been used up.

Certain group and most individual long-term care insurance plans have preferred risk discounts. We believe the CLASS Program has no apparent answer to this feature.

Expenses

The statute contains the following provision regarding administrative expenses (emphasis added): “In *determining the monthly premiums* for the CLASS program the Secretary *may factor in* costs for administering the program, not to exceed . . . an amount equal to 3 percent of all premiums paid during the year.”³⁹ Expenses for protection and advocacy services and advice and assistance counseling are counted as administrative expenses⁴⁰.

It is our opinion that there is no explicit restriction on the *actual* administrative expenses. Other than the initial roll-out, there is no guarantee of additional federal funding in support of these services. It would be unrealistic and undesirable to limit actual administrative expenses to only 3% of premiums (see our estimate below). Such a limitation would allow for little or no advocacy services or advocacy and assistance counseling. Claim payments might not be made on time. Enrollment might have to be curtailed. Experience monitoring might not be done to ensure timely premium adjustments in order to maintain solvency. Fraud and abuse prevention and monitoring might be limited or non-existent. These events would adversely affect the integrity and ultimate existence of the Program.

There is an important distinction between expense assumption in the premium development and actual future expenses which are not guaranteed to be realized. The process of determining premiums involves making assumptions regarding future claims, investment returns, persistency, as well as expenses. None of these assumptions can be guaranteed to hold during the lifetime of the enrollees in the Program. In order for the plan to be actuarially sound and the Program to be sustainable, these assumptions must be realistic. In selecting these assumptions, we anticipate that favorable experience for one of these factors may offset unfavorable experience for another such that the plan is overall actuarially sound. For example, favorable claim experience can offset unfavorable investment experience, leaving the Program actuarially sound overall. The statutory provision may necessitate choosing assumptions that are expected to be reasonable in the aggregate, with some conservative margin incorporated into the other assumptions to compensate for the aggressive 3% expense assumption.

³⁹ CLASS Act, Sec. 3203(b)(2).

⁴⁰ CLASS Act, Sec. 3205(b)(4).

Our current estimates of Program expenses expressed as percentages of premiums are as follow:

Enrollment and enrollee services	5.5%
Claim administrative expenses	10.0%
Counseling expenses	3.0%
CLASS Office overhead	1.5%
Total	20.0%

These expenses are derived from a survey of the pricing expense assumptions of group long-term care insurance and experience from the Federal Long Term Care Insurance Program. We expect that these expenses will rise according to the CPI. Because certain components of these costs are fixed or not a function of premiums, these percentages reflect the relatively low estimated average premium (under \$1,000 annual premium) compared to other forms of insurance (for example, health insurance). Thus metrics from other insurance are not always directly transferrable to the CLASS Program.

The statute is silent on the use of investment returns from the trust fund. Because premiums collected are expected to exceed benefits and expenses in the early years, we expect considerable build-up of the balance in the trust fund. Investment returns from the trust fund are a source of revenue in addition to premiums. This revenue can be used to cover expenses.

Rather than modeling expenses solely as a percentage of premiums, a more appropriate set of expense assumptions would delineate the following:

- fixed expenses,
- expenses that vary by the number of enrollees,
- expenses that vary by the number of beneficiaries and the length of the claims, and
- expenses by vary by premiums.

Compared to the simplistic assumption based on premiums alone, this approach will minimize the likelihood of actual expenses exceeding expected expenses due to incorrect estimation of the average premium per enrollee.

Minimum Earnings Requirement and Nominal Premium

Under the statute, eligible beneficiaries must meet a minimum earnings requirement for 3 out of the first 5 years of enrollment equal to the amount of wages to be credited with one

quarter of Social Security coverage⁴¹. This amount is \$1,120 for 2011. However, the Secretary is authorized to make exceptions to this rule for certain populations⁴². A low minimum earnings requirement allows enrollment of low-income workers who, as a group, are generally in poorer health⁴³.

Furthermore, the statute requires a \$5 nominal monthly premium for enrollees whose income is below the poverty line or who are full-time students under age 22⁴⁴. This provision poses a potential threat to the financial viability of the CLASS Program. Without any mitigation for adverse selection, this is a tremendous incentive for a poor worker, who is near or already met the benefit triggers, to enroll. The 'returns' in the form of benefits (approximately \$18,000 a year for the first year and indexed higher thereafter) far exceed the 'investments' of 5 years of \$5 monthly premiums (\$300). Because other enrollees will be subsidizing the poor, the overall premiums will need to be higher than without this subsidy. This adds to the competitive issue with private insurance. In addition, estimation of the appropriate premiums will not be reliable due to the unpredictable mix of nominal and regular premiums.

In order to mitigate this threat, raising the minimum earnings requirement for certain enrollees so that it is always above the poverty level could be explored. This should be somewhat effective in controlling adverse selection by those who expect to receive a high level of benefits for very little premium.

As stated above, the Secretary is authorized to promulgate regulations on exceptions to the minimum earnings requirement for certain populations. Under the Phased Enrollment plan design, those enrolled through individual enrollment are certainly a population that needs special attention since most of the adverse selection is expected to come from this group. Under the Temporary Exclusion design, the potential problem is less severe but not entirely eliminated. In either case, raising the minimum earnings requirement on this group would help. In addition, since it is not explicitly prohibited, defining "actively employed" to require a minimum number of work hours at time of enrollment can also help to mitigate adverse selection. Finally, there should be a specific regulation to prevent companies from forming for the sole purpose of enrolling employees into the CLASS Program.

⁴¹ CLASS Act, Sec. 3202(6)(A)(iii).

⁴² CLASS Act, Sec. 3202(6)(C).

⁴³ See, for example, *Low-Income Workers and Their Employers – Characteristics and Challenges*, Gregory Acs and Austin Nichols, Urban Institute, 2007.

⁴⁴ CLASS Act, Sec. 3203(a)(1)(A)(ii).

Reenrollment after Lapse

For reenrollment after a lapse from the CLASS Program, the statute prescribes separate treatments based on the time period between lapse and reenrollment:

- less than 90 days,
- 90 days to 5 years, and
- over 5 years⁴⁵.

Potential for gaming exists for reenrollment after 90 days. For lapse periods between 90 days and 5 years, the statute merely requires 2 years of continuous payments (of premiums for a new enrollee at the same attained age at reenrollment) and the initial 5 year vesting period before claiming. This encourages a 'skip-and-go' scheme where an enrollee would lapse, reenroll within 5 years from lapse, pay a premium, lapse again, and reenroll permanently only when his or her health deteriorates. If the lapse period is over 5 years, a similar but slightly less devious gaming opportunity also exists if no control is in place.

We propose the following rules in order to treat the reenrolled individuals and the in-force enrollees equitably. If the lapse period is less than 90 days, payment of due premiums is required to maintain enrollment. If the lapse period is between 90 days and 5 years, the individual must:

- Pay all back premiums except for the first lapse,
- Pay future premiums based on the attained age at reenrollment, and
- Meet the minimum earnings requirement again, or restart the 15 year exclusion period if the plan included Temporary Exclusion.

If the lapse period is over 5 years:

- Meet the minimum earnings requirement again,
- Pay future premiums based on the attained age, and
- Pay an actuarially sound premium that anticipates the enrollee will be very likely to claim or restart the 15 year exclusion period if the plan included Temporary Exclusion.

⁴⁵ CLASS Act, Sec. 3203(b)(1)(C) and Sec. 3203(b)(1)(E).

Minimum \$50 Average Daily Benefit

The statute requires that the daily benefits paid be at least \$50 on average as determined based on the reasonably expected distribution of beneficiaries receiving benefits at various benefit levels⁴⁶. There are numerous ways to interpret this requirement. The \$50 minimum could apply to each year's claims and the averages could be determined on a present value basis. We have identified the following 6 methods of calculations that can fit this requirement:

1. At the beginning of each year, the present value of all expected future benefits from all enrollees divided by the total expected future days of claims from all enrollees.
2. At the beginning of each year, the present value of all expected future benefits of new beneficiaries during the past year divided by the corresponding total number of claim days.
3. At the beginning of each year, the present value of all expected future benefits of all beneficiaries during the year divided by the corresponding total number of claim days.
4. The total expected daily benefits available each year for all beneficiaries divided by the total expected number of claim days.
5. For each new beneficiary, the expected total future payments divided by the expected total number of days in claim.
6. The expected total future payments to each beneficiary for each 12 month period divided by the expected future number of days in claim during such period.

Another related issue is whether the minimum \$50 is indexed by CPI or not. While it is clear that benefits are indexed after claim, it is not clear that benefits are required to be indexed while the enrollee is active past the first 5 years of the program, but not in claim status⁴⁷. Note that we have proposed the benefit amounts starts indexing on the second year of an individual's enrollment, which is the most liberal interpretation.

We take the position that the \$50 minimum average is not indexed and elects the first calculation method described above. We plan to monitor actual results and adjust benefits if necessary in order to comply with the requirement.

⁴⁶ CLASS Act, Sec. 3203(a)(1)(D)(i).

⁴⁷ CLASS Act, Sec. 3205((b)(1)(a).

Actuarial Modeling

The Office of the Assistant Secretary for Planning and Evaluation (ASPE) in HHS contracted Actuarial Research Corporation and Avalere Health to independently develop financial models for the CLASS Program. Both models can determine premiums and project financial results of various CLASS plan designs. Both models are capable of estimating the impact of adverse selection on the premiums and program results. This impact is made a function of the expected enrollment rate of all the workers in the workplace. The higher the enrollment rate, the lesser is the adverse selection effect and vice versa. Each model uses a different source of population data to estimate prevalence, incidence and continuance rates of the use of long-term care services. Entry age premiums are determined by equaling the present value of premiums with the present value of benefits and expenses over the expected lifetime of the enrollees. Program financial results are then derived from projections of the total premiums, investment returns, benefits and expenses. The two models produced consistent and similar results.

A technical expert panel comprised of economists and actuaries was assembled in September, 2010 to provide inputs and comments to the model construction. Another panel convened in June, 2011 to discuss model assumptions and alternative CLASS plan designs. These meetings, together with the results from the models, have been helpful in formulating the direction of the CLASS Office regarding plan designs.

Subsequent to the expert panel meetings, the HHS actuaries and actuaries from the Social Security Administration met in late June, 2011 to review plan design alternatives. This group agreed that certain plans, designed to mitigate the adverse selection risk (Phased Enrollment, for example), can be actuarially sound and attractive to the consumers.

Marketing Considerations

Product design and marketing go hand-in-hand together. Without an attractive product, marketing efforts would be fruitless. Consumer expectation and competition set the requirements for a marketable product design. We believe certain proposed plan designs and the proposed features described in this report have the ingredients for an attractive product. It remains to be seen how the designated plan can be successfully marketed in the worksite marketplace.

There are approximately 140 million workers in the United States. The market in the worksites can be roughly divided into 3 categories: large employers with over 5,000 employees, medium-sized employers with 1,000 to 5,000 employees and the remaining are small employers. There are approximately 8,500 employers with more than 1,000 employees. Included are public employee groups. These three categories deserve

distinctive marketing approaches. Workers to be enrolled through individual enrollment would also need special attention.

We intend to assist in developing marketing tactical plans with the intention to leverage the CLASS Program's position in the following areas.

Product Differentiation

The most distinguishing feature of the CLASS plan will be the benefit features. Most private insurance's benefits are rule-based where limits and restrictions are specifically designed to control claim costs. Recognizing that each beneficiary's needs are unique, CLASS benefits are beneficiary-driven. Beneficiaries can expect to have greater control on how benefit dollars are spent than in private plans.

A relatively novel feature is the increasing premium schedule. We believe it has a clear advantage over level premium plans because of its low entry price point. Compared with many group long-term care insurance programs where the option for benefit increases requires increasingly expensive premiums (commonly known as Guaranteed Purchase Option), the scheduled premiums in CLASS are known in advance and level in later ages. Thus CLASS offers more affordable inflation protection because there is no price pressure during retirement.

Lastly, unlike private insurance, CLASS plan's benefits will vary by the level of disability.

Existing Group Plans

Approximately half of the large employers already have group long-term care insurance in place. A significant number of them no longer enroll workers. This can present an opportunity for the CLASS Program to be the successor insurer for future enrollments. CLASS can be the sole insurer by offering an optional number of units of insurance, with a \$50 daily benefit as one unit. Alternatively, CLASS can partner with a private insurer to offer a packaged program.

Relationship with Private Insurance

The CLASS Program can compete directly against private insurance or work in concert with it. As a competitor in the private insurance's space, the CLASS Program can offer coverage of multiple units of a \$50 initial daily benefit. However, CLASS may be at a disadvantage because we currently have no intention to factor in significant marketing costs. Driven by commissions, insurance brokers would likely sell against CLASS.

As an alternative approach, the CLASS Program can focus on the low to middle income workers where private insurance has generally been unsuccessful. However, since they have limited discretionary income for insurance, enrollments will likely be low. Moreover, it

is our impression that claim experience in other types of insurance has been generally unfavorable for these workers.

A better approach would be for private insurance to be a supplemental plan to the CLASS plan. The CLASS plan would provide the first layer of coverage. If the enrollee desires more coverage and is insurable (this may or may not be a requirement), he or she can purchase the private plan at the same time or in the future. The CLASS Program would benefit because the package will be co-marketed. The CLASS Program would gain a broader spread of risk by attracting higher income workers. Private insurance would benefit from the publicity and awareness generated by the CLASS Program.

A potential issue is having private insurance conform to the CLASS plan's features regarding benefit eligibility, benefits, etc. The CLASS Program can set up plan feature criteria whereby private plans can receive a "seal of approval" to market along with the CLASS plan. The list would include features that make the private plan resemble the CLASS plan as closely as possible. Another potential issue is the coordination of enrollment and premium administration.

Still another idea is for the insurers act as reinsurers for CLASS. Insurers would assume the morbidity risk while CLASS retains the persistency, investment return, inflation and expense risks. For the consumers, a partnership might be a stronger brand than the individual competing entities. The product would be seamless and premium rate stability could be enhanced. The CLASS Program would reduce its exposure for morbidity risk, get more enrollments than by it alone, and possibly achieve certain administrative cost savings. For the insurers, this partnership could ensure their future growth in the morbidity risk segment of their business where they have sufficient experience and is less problematic than other risks (for example, investment risk). It could revitalize their sales.

Internally, the reinsurance arrangement would be a yearly assessment of the actual claim experience to the expected claims in the premiums (with a long period of commitment). The arrangement would have the insurer pay claims up to, say, 160% of actual to expected claims. Beyond 160%, CLASS will have to absorb the risk, meaning there would likely be a premium rate increase at that point. Externally, the plan could possibly take on certain design differences by the insurers (such as benefit period, premium schedule, etc.) while keeping the basic CLASS features. We expect that the CLASS plan premiums will be slightly more expensive with this arrangement due to reinsurance costs.

Volume Illustration

Without a designated plan and a specific marketing strategy, it is premature to project volume for the CLASS Program. However, it would be useful to understand the financial implication of various scenarios.

We constructed a simplified model for this exercise. The model divides the current working population by size of employee groups. It assumes certain penetration rates by group size over a 10-year period based on the differences between expected ultimate penetration rates and current penetration rates. The expected ultimate penetration rates are based on other lines of voluntary insurance such as life and disability income insurance. The current penetration rates are based on private long-term care insurance data. From the penetration rates, enrollments are projected over a 10-year period. The model also contains assumptions regarding premium rates, expenses, benefits, investment returns and persistency. With these assumptions, we generated financial results for the first 10 years of the CLASS Program.

We developed results for 3 volume scenarios: minimum, expected and optimistic. In the minimum scenario, we solved for the minimum number of enrollments so that the Program is self-supporting by covering the cost of the CLASS Office staff and other expenses. The optimistic scenario depicts what may happen in an ideal market environment. The expected scenario is what may happen with a reasonable marketing effort but with no change to the current market environment.

	Minimum	Expected	Optimistic
Number of Enrollees	124,000	2,137,000	14,018,000
% of Work Force	0.1%	1.5%	10.1%
Fund @ End of 10 years (\$B)	\$0.6	\$11.8	\$66.3

The projected fund balance for the optimistic scenario is close to the Congressional Budget Offices' (CBO) \$72 billion estimate⁴⁸. The CBO's estimate was based on a \$123 average monthly premium. In contrast, all 3 scenarios assumed an \$80 average initial monthly premium. The optimistic scenario is possible, for instance, if there are cuts in Medicaid and Medicare long-term care benefits coupled with a tax incentive to encourage CLASS participation.

Actuarial Oversight

Actuarial oversight plays a significant role according to the statute. "The Secretary, in consultation with appropriate actuaries and other experts, shall develop at least 3 actuarially sound benefit plans as alternatives for consideration for designation by the Secretary as the CLASS Independence Benefit Plan"⁴⁹.

⁴⁸ CBO letter to Rep. George Miller from Douglas Elmendorf, November 25, 2009.

⁴⁹ CLASS Act, Sec. 3203(a)(1).

With respect to actuarial analysis, the statute requires:

- (III) “a statement of the actuarial status of the CLASS Independence Fund for the current fiscal year, each of the next 2 fiscal years, and as projected over the 75-year period beginning with the current fiscal year; and
- (IV) an actuarial opinion by the Chief Actuary of the Centers for Medicare & Medicaid Services certifying that the techniques and methodologies used are generally accepted within the actuarial profession and that the assumptions and cost estimates used are reasonable;”⁵⁰.

With regard to the CMS Chief Actuary’s responsibility, there is a wide range of what can be considered as ‘reasonable’ assumptions. Because of the sensitivity of results from changes in assumptions and the potential negative impact from mispricing, reasonableness should have a stringent connotation. The assumptions chosen for the CLASS plan should produce premiums that have a good chance to be stable. This applies both to assumption settings for the purpose of developing plan premiums and for assessment of actuarial soundness of the Program in the future.

Accordingly, we believe it is prudent that the process of assumption setting follows these guidelines:

- Recognizing the extreme difficulty in estimating the effect of adverse selection, plan designs should avoid the potential for adverse selection and moral hazard as much as possible.
- Assumptions must be chosen with extreme care and after considerable deliberation. Obtain as much relevant experience as possible from multiple sources. Appropriate credibility standards should be followed.
- Include margins for adverse deviation in the assumptions. Use sensitivity testing of projected financial results to evaluate the margins.

Pricing Risks

It should be noted that long-term care insurance programs are characterized by low incidence rates and relatively high benefit amounts. Claim costs are typically low at the early ages of the enrollees but increase substantially at later ages beyond retirement. The typical time to claim from enrollment is over 10 years. Consequently, small changes in assumptions regarding future events will have a large effect on premiums. As experience from private

⁵⁰ CLASS Act, Sec. 3206(c)(2)(B)(i)(III - IV).

long-term care insurance has revealed, the likelihood for misjudging future costs is significant.

Even though efforts will be made to mitigate adverse selection and to use private group insurance data as a base for claim assumptions, several mispricing opportunities remain:

- The impact of adverse selection for the CLASS Program may not be identical to that for guaranteed issue group long-term care insurance.
- Long-term interest return and future benefit inflation rate are difficult to forecast.
- The induced demand due to payments to family members, especially spouses, is largely unknown.
- The additional claims due to Temporary Exclusion over the base claim assumption has not been quantified.
- The \$5 subsidized premium has not been completely removed.
- Possibilities exist for organized efforts to enroll workers with functional limitations.

Next Steps

We will continue our actuarial work in two phases. We will complete plan development first and then turn our attention to plan implementation.

Development

1. Conduct a survey of long-term care insurance experience on group business,
2. Obtain legal clearance on plan designs and features,
3. Assist in finalizing proposed plan features,
4. Assist in developing marketing strategic and tactical plans, including potential for co-marketing with insurers,
5. Develop recommended premiums and project financial results,
6. Perform sensitivity analysis including stochastic modeling, and

7. Obtain external review on premium adequacy.

Implementation

1. Assist in the rule-making process,
2. Assist in the procurement process for administrative services,
3. Develop a risk management process for Program implementation,
4. Design a study of health status of enrollees,
5. Develop an actuarial review process, and
6. Develop a process to determine enrollees' individual equity for the purpose of program termination or transfer.

Summary

We believe the CLASS Benefit Plan can be designed to be a value proposition to the American workers as the CLASS Act prescribed it. Much work remains to be done on plan development. The ultimate size of its enrollment will depend on marketing efforts to produce wide public acceptance of the CLASS Program.

Attachment 1

Adverse Selection Memo

Memo: Adverse Selection
From: Bob Yee
To: Kathy Greenlee
Date: April 27, 2011

In order to use the model developed under contract by ARC as the tool to develop premiums for CLASS, I have conducted a review of the model. It takes a portion of the general working population and determines the premiums that will be sufficient to pay future benefits and expenses. I find the model performs the projection calculations correctly given a set of specific assumptions. These assumptions of future events (claim rates, claim severity, mortality rates, lapse rates, expenses and investment yields) are derived mostly from population data and related experience in private long-term care insurance.

A major departure from the experience of private insurance is the effect of adverse selection arising from the lack of underwriting in CLASS. Private insurance provides little help as it is almost always underwritten. The ARC's model expresses the adverse selection effect as a load to the normal expected claim costs without adverse selection. This load represents the anticipated higher proportion of unhealthy enrollees than in a normal mix of healthy and unhealthy workers.

The initial load is assumed to be a function of the enrollment rate and the prevalence rate of severely disabled (i.e. benefit qualifying) enrollees. The load decreases monotonically in time to no less than 10% (see attached exhibit for a more detailed description). While this formula is plausible, the resulting load to the normal expected claim costs is subjective and not supported by actual experience. Moreover, this is only one possible approach and may not even be correct. One can argue that the load may be increasing in the future when all unhealthy enrollees, initially qualified for benefits or not, are taken into account.

In order to illustrate the possible range of the adverse selection effect, I calculated the two end points of the range using the model. The monthly premium for an enrollee age 50 at time of enrollment is \$60 with no adverse selection¹. The corresponding monthly premium with full adverse selection (i.e. all enrollees are qualified for benefits at time of enrollment) is \$564, or 9 times. It would even be much higher if claim severity is appropriately adjusted for these enrollees. The

¹ The plan tested is the 'Modified' CLASS with waiver of premium and 2% enrollment rate. 'Modified' here refers to the CLASS plan with the proposed Senate amendments (in particular, allowed for indexing of premiums).

model generates a monthly premium of \$93 using its adverse selection formula. This wide range bracketing the model premium suggests that the extreme sensitivity of the adverse selection assumption needs to be considered when developing the CLASS premiums.

Our task at hand is not merely to produce 'best-guess' premiums from a set of assumptions. The proposed plan(s) must be actuarially sound. In conjunction with other provisions, the CLASS Act imposes a rather severe condition for actuarial soundness. That is, the CMS actuary must certify that the assumptions associated with the premiums are reasonable in order to ensure that the CLASS program is sustainable over 75 years.

In practice, this is perhaps a more formidable task than the corresponding financial oversight in private insurance. From a solvency perspective, private long-term care insurers are typically multi-lined insurers and their solvency is spread over other lines of business, such as life insurance, annuities, disability insurance, etc. CLASS has only one line; it has no other apparent sources for support. Besides the various underwriting techniques to mitigate adverse selection, insurers control their risk exposure by phased roll-outs over a period of time and by adjusting premiums for newly issued policies. The CLASS program will be made available with limited restrictions through both individual and employer-based enrollment. It will be exposed to an unknown degree of adverse selection at the onset. Premium revision for future enrollees may be too little and too late to temper a large premium deficiency already in the program. Quick premium revision may be seen as a sign of program instability, thus affecting subsequent enrollment results. CLASS essentially has only one shot to get it right.

As we have discussed previously, if the premiums are not set properly, the required premium rate increase may be substantial. In private long-term care insurance, large rate increases have often led to disastrous rate spirals. This is so because the increases are driving out the healthy insureds as premiums become increasingly unaffordable. This is an unacceptable scenario for CLASS.

The impact of adverse selection on claim experience is driven by the proportion of unhealthy enrollees in the program. Low enrollment generally means greater likelihood of an unfavorable proportion of unhealthy enrollees. It is a basic insurance principle that any sound insurance program has a good spread of risk. That is, there is an appropriate mixture of healthy and unhealthy enrollees to keep the premiums reasonable and stable.

Success in CLASS enrollment will largely depend on the price point and actions from private insurance. CLASS premiums must be attractive relative to the perceived value of the benefits. They will be compared to the respective premiums of private plans. We have previously shown that the premiums from the model are

approximately twice that of private group plans with similar benefits. Moreover, agents will be inclined to sell against CLASS to the healthy workers. The proportion of unhealthy enrollees will be dependent on the mixture of individual and worksite enrollment. This proportion is subject to systematic encouragement for enrollment by certain organizations. Because the CLASS program allows individuals to enroll directly, it cannot effectively control the influx of unhealthy workers. The actual results for enrollment and proportion of unhealthy enrollees are highly unpredictable.

To illustrate this another way, there are approximately 200,000 workers with 2+ ADLS or cognitive impairment out of approximately 100,000,000 workers². The normal annual claim rate is less than 2% but it is 100% for these severely disabled workers. Thus these workers are more than 50 times more likely to claim than the average workers in a given year. Suppose we decided that a 20% load³ for adverse selection is marketable against private insurance that has no such load. It would then take 22 healthy enrollees over a 10 year period to support one such disabled enrollee who can readily claim⁴. In 2010, there were approximately 187,000 policies issued under group long-term care insurance primarily to workers⁵. Even if we are wildly successful by enrolling half of this figure in one year, we can only allow up to 4,300 workers (less than 3% of the total) who have 2+ADLs or cognitively impaired to enroll before the loaded premiums are inadequate.

Without a valid value proposition to the healthy workers, empirical evidence or any risk mitigating measures, there is great uncertainty in quantifying the adverse selection effect. With its theoretical formula, the ARC model is useful in demonstrating its impact on premiums. However, the model, by itself, should not be relied upon for prudent rate setting.

Uncertainty calls for conservatism. My current professional opinion is that the actuarially sound premiums for the basic CLASS plan in the statute, as well as the so called "Modified" CLASS plan, are that of a pre-paid plan⁶.

It is not a coincidence that many experts have maintained that adverse selection is the major obstacle for the CLASS program. Any workable design must address it in order to receive certification as an actuarially sound plan.

² 2009 National Health Interview Survey and 2009 Current Population Survey (PINC-05) people age 15+ with annual income greater than \$12,500.

³ We can expect that any load much above 20% will dramatically reduce enrollment to a point where the proportion of unhealthy enrollees is intolerable.

⁴ This illustration conservatively ignored those enrollees who are disabled but do not yet qualify for benefits under CLASS.

⁵ 2011 LifePlans estimate.

⁶ A pre-paid plan, such as a dental plan, anticipates that nearly everyone who enrolled will claim. Thus the premiums approach the value of the benefits.

Attachment 2

Plan Design Alternatives

Plan Alternatives Category I: Adverse selection issue not addressed

Design	1 CLASS Basic	2 Modified CLASS
Description	This is the plan closest to CLASS specs	This plan incorporated the proposed Senate amendments
Benefits	\$50 daily benefit indexed to CPI every year only after claim and not while active 5 year waiting period	\$50 daily benefit indexed to CPI 5 year waiting period
Premium Schedule	Level premium	Premium indexed to CPI
Price Competitive	x	x
Benefit Attractive	x	✓
Compatible with Private Insurance	Not compatible	Not compatible
Remark	Premium will be unstable because private insurance will be much cheaper The stable premium will be at a pre-paid plan level	Include higher earning threshold for first 5 years The stable premium will be at a pre-paid plan level

Note: All alternatives assumed that earnings and re-enrollment issues have been addressed.

Plan Alternatives Category I: Adverse selection issue not addressed

Design	3 <i>Short & Fat Option</i>	4 <i>Wellness Option</i>
Description	Choice of <i>CLASS Senate</i> or a plan that provides substantial benefits for a short period	Choice of <i>CLASS Senate</i> or a plan that provides an incentive to stay out of claim
Benefits	\$150 daily benefit indexed to CPI (e.g.) 2 year benefit period (e.g.) 5 year waiting period	\$150 daily benefit indexed to CPI (e.g.) If there is no prior claim, 1 year of premium is refunded for every 10 year period (e.g.) 4 year benefit period (e.g.) 5 year waiting period
Premium Schedule	Premium indexed to CPI	Premium indexed to CPI
Price Competitive	x	x
Benefit Attractive	✓	✓
Compatible with Private Insurance	Compete directly with private insurance but at higher premium	Compete directly with private insurance but at higher premium
Remark	Does not address disabled workers with < 2+ ADLs	Marginal improvement on anti-selection

Plan Alternatives Category II: Adverse selection issue somewhat addressed but low product appeal

Design	5 <i>Rising Benefit Option</i>	6 <i>Shadow Benefit</i>
Description	Choice of <i>CLASS Senate</i> or a plan that provides minimal benefits during an initial period	Lower benefits for the first 20 years
Benefits	\$25 initial daily benefit indexed to CPI in years 1-10, \$50 indexed for years 11 -20, \$150 indexed thereafter (e.g.) 4 year benefit period (e.g.) 5 year waiting period	After 20 years, pays \$50 indexed to CPI; pays \$10 level during the first 20 years (e.g.) 4 year benefit period (e.g.) 5 year waiting period Sold in units of \$50 daily benefit; can buy up to 8 units
Premium Schedule	Premium indexed to CPI	Premium indexed to CPI
Price Competitive	x	✓
Benefit Attractive	✓?	x
Compatible with Private Insurance	Relying on private insurance to provide meaningful coverage to most workers	Opportunity for private insurance to supplement (if limited to 1 to 2 units) but compete directly if up to 8 units
Remark	More expensive package than private insurance Less anti-selection but uncertain to the exact degree	Less anti-selection but uncertain to the exact degree More attractive to younger workers who are tougher to convince to enroll

Plan Alternatives Category II: Adverse selection issue somewhat addressed but low product appeal

Design	7 <i>Waiting Period Option</i>	8 <i>Life Cycle Option</i>
Description	Choice of <i>CLASS Senate</i> or a plan that has a 15 year waiting period (e.g.)	Choice of <i>Delay Benefit</i> plan or a Critical Illness (CI) and LTC combination plan
Benefits	Pays \$50 daily benefit indexed to CPI 4 year benefit period (e.g.) 15 year waiting period (e.g.) Sold in units of \$50 daily benefit; can buy up to 8 units	Intended for young workers - enrollment ages < 50 CI requires simplified underwriting 100% of private critical illness insurance & 20% of CLASS LTC benefits until age 60, 100% LTC and 20% CI at age 65, graded in between (e.g.) Benefits indexed to CPI
Premium Schedule	Premium indexed to CPI	Premium indexed to CPI
Price Competitive	✓	✓
Benefit Attractive	✓?	✓
Compatible with Private Insurance	Opportunity for private insurance to supplement	Require private CI insurance for the initial CI coverage
Remark	Less anti-selection but uncertain to the exact degree A more restrictive version of Shadow	Attract young buyers by addressing current needs Suitable as an option for young workers in addition to a standard CLASS offer

Plan Alternatives Category II: Adverse selection issue somewhat addressed but low product appeal

Design	9 <i>CLASS with Long Elimination Period I</i>	10 <i>CLASS with Long Elimination Period II</i>
Description	CLASS as 2nd payer after private insurance	CLASS as 2nd payer after private insurance or self funding
Benefits	Require private insurance purchase After first 2 years, CLASS will pay for 3 years if claim lasts past 3 years (e.g.) Sold in units of \$50 daily benefit; can buy up to 8 units	After first 2 years, CLASS will pay for 3 years if claim lasts past 3 years (e.g.) Sold in units of \$50 daily benefit; up to 8 units <i>Alternative:</i> If claim during the first 15 years, the deductible equals to the difference in cumulative premiums of a pre-paid plan and the premiums paid.
Premium Schedule	Premium increases 5% each year until age 70	Premium indexed to CPI
Price Competitive	x	x
Benefit Attractive	✓	✓
Compatible with Private Insurance	Require private insurance as the 1st payer	Private insurance can be the 1st payer
Remark	Must pass underwriting of private insurance plan CLASS plan may be viewed as superfluous	Less anti-selection but uncertain to the exact degree CLASS plan may be viewed as superfluous

Plan Alternatives Category III: Adverse selection issue addressed with reasonable product appeal

Design	11 Temporary Period Exclusion	12 Phased Enrollment	13 Underwriting Option
Description	Delay benefits for certain enrollees under certain conditions	Group enrollment first, individual enrollment later after sufficient reserve built up to allow a controlled level of adverse selection.	Choice of CLASS Senate or a plan that requires underwriting
Benefits	Pays \$50 average daily benefit indexed to CPI but no benefits for first 15 years if ADL or cognitive deficits are results of condition at time of enrollment (e.g.) Unlimited but 20% after 4 years (e.g.) 5 year waiting period Sold in units of \$50 daily benefit; up to 8 units	Pays \$50 average daily benefit indexed to CPI Unlimited but 20% after 4 years (e.g.) 5 year waiting period Sold in units of \$50 daily benefit; up to 8 units	Underwritten plan pays \$50 daily benefit indexed to CPI Unlimited but 20% after 4 years (e.g.) 5 year waiting period Sold in units of \$50 daily benefit; up to 8 units
Premium Schedule	Premium indexed to CPI	Premium indexed to CPI	Premium indexed to CPI
Price Competitive	✓	✓	✓
Benefit Attractive	✓	✓	✓
Compatible with Private Insurance	Opportunity for private insurance to supplement (if limited to 1 to 2 units) but compete directly if up to 8 units	Opportunity for private insurance to supplement (if limited to 1 to 2 units) but compete directly if up to 8 units	Opportunity for private insurance to supplement (if limited to 1 to 2 units) but compete directly if up to 8 units
Remark	Less anti-selection but uncertain to the exact degree Potential claim adjudication issues	Less anti-selection but uncertain to the exact degree Individual enrollment may be very restrictive, far into the future or never happen	Competitive and attractive alternative to private insurance

Attachment 3

Summary of Proposed Plans

Summary of Proposed CLASS Benefit Plans

	Proposed Plan 1 Phased Enrollment	Proposed Plan 2 Phased Enrollment + Temporary Exclusion	Proposed Plan 3 Phased Enrollment + Limited Initial Benefits	Proposed Plan 4 Temporary Exclusion	Proposed Plan 5 Scheduled Increasing Benefits	Proposed Plan 6 Pre-Paid
Description	Group enrollments first, number of individual enrollments based on number of enrollees through group enrollment	Phased enrollment as with Proposed Plan 1 plus temporary exclusion of benefits for the first 15 years of the beneficiary's enrollment due to a serious prevailing medical condition at time of enrollment that caused the functional limitation. Waived for group enrollment.	Phased enrollment as with Proposed Plan 1 plus low daily benefit for duration of claim, if claimed during the first 20 years of the beneficiary's enrollment. Waived for group enrollment.	Temporary exclusion of benefits for the first 15 years of the beneficiary's enrollment due to a serious prevailing medical condition at time of enrollment that caused the functional limitation.	Scheduled increasing benefits for first 25 years, can be packaged with private insurance so that the total benefits at the same level as the ultimate benefit. Require offer of a basic CLASS plan (i.e. Proposed Plan 6 – Pre-Paid Plan).	No restriction on benefits from enrollment methods, from time of claim or medical condition at time of enrollment.
Benefit Eligibility & Amounts	<ul style="list-style-type: none"> • All claim years: <ul style="list-style-type: none"> ○ \$50 daily benefit for 2 or 3 ADLs ○ \$60 for 4+ ADLs or cognitive impairment • Indexed by positive change in annual CPI 	Same as Proposed Plan 1	<ul style="list-style-type: none"> • If claimed during first 6-20 years of enrollment: <ul style="list-style-type: none"> ○ \$5 daily benefit for 2 or 3 ADLs; ○ \$6 for 4+ ADLs or cognitive impairment, not indexed until claim • After 20 years: <ul style="list-style-type: none"> ○ \$50 daily benefit for 2 or 3 ADLs; ○ \$60 for 4+ ADLs or cognitive impairment • Indexed by positive change in annual CPI 	Same as Proposed Plan 1	<ul style="list-style-type: none"> • If claimed during 6-25 years of enrollment: <ul style="list-style-type: none"> ○ \$20 daily benefit in year 6 for 2 or 3 ADLs, increased by \$6.50 each year ○ \$24 daily benefit in year 6 for 4+ ADLs or cognitive impairment, increased by \$7.80 each year • After 25 years: <ul style="list-style-type: none"> ○ \$150 daily benefit for 2 or 3 ADLs ○ \$180 for 4+ ADLs or cognitive impairment • All daily benefits also increase by 3% each year • Private insurance can provide benefits (with or without underwriting) such that the total benefits from year 1 equal to the ultimate benefits after 25 years 	<ul style="list-style-type: none"> • All claim years: <ul style="list-style-type: none"> ○ \$50 daily benefit for 2 or 3 ADLs ○ \$60 for 4+ ADLs or cognitive impairment
Benefit Duration	100% of benefit amounts for first 5 claim years, 20% thereafter	Same as Proposed Plan 1	Same as Proposed Plan 1	Same as Proposed Plan 1	100% of benefit amounts for first 3 claim years, none thereafter	Same as Proposed Plan 1

Summary of Proposed CLASS Benefit Plans

	Proposed Plan 1 Phased Enrollment	Proposed Plan 2 Phased Enrollment + Temporary Exclusion	Proposed Plan 3 Phased Enrollment + Limited Initial Benefits	Proposed Plan 4 Temporary Exclusion	Proposed Plan 5 Scheduled Increasing Benefits	Proposed Plan 6 Pre-Paid
Other Benefit Features	<ul style="list-style-type: none"> Benefit approved on last day of a month, payment begins on the following day Benefits deposited in Independence Account at beginning of every week Can carry over month to month but not year to year Debit card issued to pay for services & support; cannot be used to withdraw cash Plan of care required Counselor assigned (cost of counseling not charged to benefits) List of excluded services & support; counselor can make exceptions Payment to spouse limited to \$10/day indexed (or 20% of daily benefit if less) For payments to non-agency direct care workers, beneficiary must use fiscal intermediary; cost is subtracted from benefit amount 					
Spousal Shared Benefit	If a couple is enrolled, no benefit reduction after 5 claim years up to the unused portion of the other spouse's first 5 claim years (e.g., the couple shares up to 10 years worth of benefits, up to 6 years for Scheduled Increasing Benefits)					None
Premiums	<ul style="list-style-type: none"> 4% annual increase that stops at age 70 or after 5 years of enrollment, if later Premium schedules vary by age at enrollment (or age at reenrollment if reenrolled after 90 days from lapse) If requested, can freeze premium with a reduction on daily benefits; if premiums increase for reasons other than the annual increase, "frozen" premiums are not exempt 				<ul style="list-style-type: none"> 3% annual increase each enrollment year to age 65 Remain level at and after age 65 	<ul style="list-style-type: none"> Level premium Premiums vary by age at enrollment (or age at reenrollment if reenrolled after 90 days from lapse)
Waiver of Premiums	Premiums waived during time eligible beneficiaries are receiving benefits	Same as Proposed Plan 1	Premiums waived only if claimed after 20 years	Same as Proposed Plan 1	Premiums waived only if claimed after 25 years	Premiums not waived
Reenrollment	<ul style="list-style-type: none"> Within 90 days from lapse: <ul style="list-style-type: none"> o Pay back premiums 90 days to 5 years: <ul style="list-style-type: none"> o Pay back premiums after first lapse o Satisfy earnings requirement again o Pay future premiums based on age at reenrollment More than 5 year from lapse: <ul style="list-style-type: none"> o Satisfy earnings requirement again o Pay actuarially sound future premiums 	<ul style="list-style-type: none"> Within 90 days from lapse: <ul style="list-style-type: none"> o Pay back premiums More than 90 days: <ul style="list-style-type: none"> o Pay back premiums after first lapse o Satisfy earnings requirement again o Pay future premiums based on age at reenrollment o Satisfy temporary exclusion again 	Same as Proposed Plan 1	Same as Proposed Plan 2	Same as Proposed Plan 1	Same as Proposed Plan 1

A REPORT ON THE ACTUARIAL, MARKETING, AND LEGAL ANALYSES OF THE CLASS PROGRAM

For additional information, you may visit the DALTCP home page at http://aspe.hhs.gov/_/office_specific/daltcp.cfm or contact the office at HHS/ASPE/DALTCP, Room 424E, H.H. Humphrey Building, 200 Independence Avenue, SW, Washington, DC 20201. The e-mail address is: webmaster.DALTCP@hhs.gov.

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Ga: <u>Federal Register</u> Announcement for Personal Care Attendants Workforce Advisory Panel	http://aspe.hhs.gov/daltcp/reports/2011/class/appGa.pdf
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	http://aspe.hhs.gov/daltcp/reports/2011/class/appI.htm
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Ja: A Profile of Declined Long-Term Care Insurance Applicants	http://aspe.hhs.gov/daltcp/reports/2011/class/appJa.pdf
Jb: CLASS Program Benefit Triggers and Cognitive Impairment	http://aspe.hhs.gov/daltcp/reports/2011/class/appJb.pdf
Jc: Strategic Analysis of HHS Entry into the Long-Term Care Insurance Market	http://aspe.hhs.gov/daltcp/reports/2011/class/appJc.pdf
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Nb: Presentation Entitled "Actuarial Research Corporation's Long Term Care Insurance Model"	http://aspe.hhs.gov/daltcp/reports/2011/class/appNb.pdf
Nc: Presentation Entitled "The Long-Term Care Policy Simulator Model"	http://aspe.hhs.gov/daltcp/reports/2011/class/appNc.pdf
Nd: Presentation Entitled "Comments on 'The Long-Term Care Policy Simulator Model'"	http://aspe.hhs.gov/daltcp/reports/2011/class/appNd.pdf
APPENDIX O: Actuarial Report on the Development of CLASS Benefit Plans	[47 PDF pages]
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APPENDIX P: June 22, 2011 Technical Experts Meeting
Full Appendix

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<http://aspe.hhs.gov/daltcp/reports/2011/class/appP.htm>

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Pa: Agenda and Discussion Issues and
Questions

<http://aspe.hhs.gov/daltcp/reports/2011/class/appPa.pdf>

Pb: Presentation Entitled "Core Assumptions and
Model Outputs"

<http://aspe.hhs.gov/daltcp/reports/2011/class/appPb.pdf>

Pc: Presentation Entitled "Actuarial Research
Corporation's Long Term Care Insurance
Model"

<http://aspe.hhs.gov/daltcp/reports/2011/class/appPc.pdf>

Pd: Presentation Entitled "The Avalere Long-
Term Care Policy Simulator Model"

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Pe: Presentation Entitled "Alternative Approaches
to CLASS Benefit Design: The CLASS
Partnership"

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APPENDIX Q: Table 2: Actuarial and Demographic Assumptions

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APPENDIX R: Figure 1: Daily Benefit Amount for Increased Benefit

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