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Looking Back on CLASS: Considerations of Market Failure and Missed Opportunities

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The demise of the CLASS Act has left some questions to ponder for private long-term care insurance. Why did CLASS get as far as it did given obvious weaknesses? Could it have been fixed if the political environment had allowed for technical corrections? What lessons were learned that might help the private market do a better job for middle-market consumers most in need of LTC insurance (LTCI)?

My perspective on these questions comes from my long involvement in leading the development and implementation of the LTCI Partnership Program that is now operating in 40 states across the country. As the original public-private long-term care insurance strategy, State Partnership programs shared with CLASS the public policy goal of helping consumers prepare for the risk of catastrophic long-term care costs. But the programs are quite different in their approaches. CLASS was intended to overcome aspects of private long-term care insurance market failure while partnership insurance is built directly on current private market LTCI offerings that meet federal and state requirements. Partnerships have faced an additional market failure challenge within the context of the broader private LTCI market that CLASS might have helped remedy; the lack of sales in the middle income market most at risk for impoverishment from catastrophic long-term care costs.

The most obvious aspect of market failure addressed by CLASS was also its biggest challenge. CLASS tried to provide insurance to those who would not be insurable in the private market. CLASS was designed for all workers, but is especially valuable for those who can afford, but cannot obtain private insurance because of pre-existing conditions.

The problem of adverse selection hung over CLASS from the very beginning. Those tasked with fixing the details of the program were required to come up with alternative options to address this challenge. Technical adjustments explored by the federal Department of Health and Human Services (DHHS) team head included tightening the enrollment rules to avoid gaming eligibility and increasing the work requirements to make it more difficult for those with disabilities to enroll. The Joint Academy/Society of Actuaries CLASS Act Task Force had called for a substantially increased minimum requirement of 20 to 30 hours of scheduled work or a comparable requirement (Schmitz, 2011). Other challenges were the proposed limited cash benefit structure paid for a lifetime ("long and lean") and how to keep premiums affordable in the face of these legislative mandates.

The CLASS legislation had called for the U.S. Department of Health & Human Services (HHS) secretary to be presented three options from which one is to be chosen. But in her public statements about the need to fix CLASS, DHHS secretary Sebelius offered one especially intriguing comment *"... we're looking at ways to make the program appealing for Americans with a wide range of long-term care needs. A CLASS program that does not take a "one-size-fits-all" approach will not only serve people better, it will also be attractive to a larger number of people (Sebelius 2011)."* This seemed to imply there could be what the final DHHS report later referred to as a "family of options" within the CLASS structure. In the end, it apparently was not possible without further legislative support (Congressional Research Service, 2011). In the context of more general opposition to health reform by the Republican controlled Congress this support was not seen as forthcoming.

The idea that there could be a family of options within the CLASS structure makes a lot of sense, but it is also risky because that could mean directly competing with the private insurance market. The CLASS Act was able to become law in part because CLASS benefits are so different from what is favored in the private market that it was not seen as a threat. The strongest private insurance advocates see viable public option alternatives as unwelcome. The strongest advocates for CLASS don't like private insurance. This is an old debate that has tormented the development of the

Partnership program throughout its development and implementation (Meiners and McKay, 1990). Still, many private insurance producers had come to feel the publicity around CLASS would help get the public's attention focused on the need for long-term care insurance, giving the market a positive boost, helping them overcome what has been an undersized market that had experience significant declines in its growth rate in recent years. But not everyone feels this way (Blasé and Hoff, 2011).

Everyone on all sides of the issue acknowledge that the long-term care insurance market is underdeveloped relative to its potential and certainly relative to the need. Part of the problem has to do with consumers being able to afford the coverage and part has to do with them being eligible to buy the coverage. Just how restrictive the private market has been in underwriting policies has been the subject of very limited research. One study estimated that if everyone applied at age 65, between 12 percent and 23 percent would be rejected (Murtaugh, Kemper, & Spillman, 1995). This suggests there are far more insurable risks than insured people. On the other hand, another study estimated that at least one older person in seven who had been rejected may not represent more risk than those accepted (Temkin-Greener, Mukamel, & Meiners, 2001). This, too, suggests there are more good risks than what the private market now covers. A number of prominent insurers have left the market recently and the number has generally been in decline over recent years (Lieber, 2010). Good risk selection is one of the keys to profitability so the incentive for those that remain in the market is to error on the conservative side.

CLASS makes long-term care coverage available to those who cannot pass insurance underwriting. This is not a problem the partnership programs are able to address. Partnership programs do focus on the challenge of selling to the "middle mass" segment of income and wealth spectrum. A Society of Actuaries' study on retirement identified this segment as representing 83 percent of households generally suited for a LTC insurance product (Society of Actuaries, 2010). The average household income of this group in the years leading up to retirement (55 – 64) is $75,000 with average assets net of home values at just over $100,000.

Most sales tend to be made at the high end of the market because that is where there is more discretionary income. Unfortunately the bulk of the potential market is not high end. The remaining 17 percent comprise the "middle affluent" segment, averaging pre-retirement household income of $132,000 and net assets of $390,000. While this segment is much more limited, there are still enough of them to hold the focus for the relatively few agents who specialize in LTC insurance.

Agents are commission driven to sell higher benefit amounts per policy. High end sales are easier and more lucrative for agents. From 1990 – 2010 the average benefits duration of policies sold has been in the range of five years (Cohen, 2011). The few sales made in the middle mass market still tend to be high-end products. In 2005, for example, the average benefit duration was 5.1 years for those with incomes of $25,000 – $49,000 and 5.3 years for those with incomes of $50,000 – $74,999, compared to 5.6 years for those with incomes of $75,000 or more (LifePlans, 2007). This has been a

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troubling form of market failure, especially if purchasers with lower incomes are giving up inflation protection to get the extended coverage that was a common trade off in the early years of the market.

The net result is a much smaller market and slower growth than is needed to help much with the public policy problem of getting people prepared financially to deal with long-term care expenses. It is the middle mass market that is most at risk for spending through their resources if long-term care is needed (Meiners, 2009).

Allowing more options within CLASS could have helped balance the adverse selection problems and contributed to the public policy goal of significantly increasing the number of people who have purchased long-term care coverage.

Both CLASS and partnership programs are focused on getting attention and coverage accepted as important to the middle mass market. Arguably the partnership "short and fat" approach (full coverage for most of the risk during the early years of need) provides a better value per premium dollar spent, than the CLASS "long and lean" approach (lifetime coverage at a low daily benefit relative to the cost of care), all else equal. But the success of partnership programs has been limited by industry resistance to making the "short and fat" products a priority. This has been a troubling form of market failure. Since its inception, the partnership has tried to encourage products that offered comprehensive benefits, but for limited periods of time (preferably in the range of the dollar equivalent of one to three years of coverage), as a way to broaden sales to the middle mass market. For reasons outlined earlier, there has been little interest or enthusiasm for selling products that cover less than three years of benefits. Yet, people could benefit from as little as a year or two of coverage to help them when a long-term care crisis hits. If they can afford more they should buy it, but many cannot. The benefit strategy promoted by partnership programs could have been included in CLASS as a way to stimulate more affordable insurance coverage whether or not the consumer can pass private insurance underwriting. Making the one- to three-year equivalent products a priority of the CLASS program could have served to stimulate this important segment of the market in both CLASS and private insurance.

CLASS could also help with market failure at the other end of the benefit spectrum. For many years lifetime protection was a major focus of the insurance industry. But lifetime benefits are only available when packaged with front-end coverage. This makes that coverage expensive. A CLASS catastrophic benefit design would be attractive to buyers from along the wealth spectrum who are willing to self insure large amounts of their long-term care expenses, but want a stop-loss insurance policy to back them up. A true catastrophic benefit structure would allow purchasers the peace of mind that their long-term care losses would be limited to an amount they could afford. With this as one of its options, CLASS could attract insurable risks that otherwise would self insure.

CLASS benefit designs that address these two areas of market failure could be offered as alternative options to the "long and lean" CLASS with all enrollees joined into a single risk pool. The new CLASS options should be significantly less expensive than the original CLASS option. Each option is attractive to different market segments and the combined risk pool could be much larger. Under this proposal, private insurance covering three years and more, the favored segment of insurance producers, would be left to the private market. This might have relieved some of the political opposition to such a proposal.

Allowing more options within CLASS could have helped balance the adverse selection problems and contributed to the public policy goal of significantly increasing the number of people who have purchased long-term care coverage. If CLASS were successful with its family of options, private market options will emerge to challenge the new CLASS options and competition will ensue. This would serve the public policy goal of getting significantly more people to prepare financially for the risk of long-term care.

One of the remarkable things about the CLASS legislation is that it passed at all. It was also not surprising to see it struggle without further technical corrections. Many key details were left to the secretary of HHS to resolve and there were considerable "devils is in the details."

One widely acknowledged benefit of CLASS was to be an increase in public awareness about the importance of insuring against long-term care risk. Another important benefit is CLASS coverage

for individuals who do not meet the underwriting requirements of private LTCI. However, the CLASS benefit structure is not right for everyone, so allowing the DHHS secretary to consider options like those proposed here should have been considered.

In the same spirit, it is also important for the states and the federal DHHS to continue to support state partnerships and educate consumers about all available long-term care insurance options. If the public education effort is successful and premiums are perceived as reasonable and reliable, larger risk pools will help balance out concerns about selection in both programs. CLASS would attract healthier risks than expected and partnership insurers will sell more "short and fat" products to middle-income purchasers, a part of the market that has been underdeveloped. This would be a step toward solving the nation's public policy challenge around long-term care. ■