Policy Briefings

The End of CLASS: An Underreported Policy Decision and America's Retirement Crisis

In recent weeks our media have mimicked the 6:00 AM alarm clock in the 1993 cult movie classic "Groundhog Day." Euro zone financial problems, Penn State sexual scandals, and year-end car deals have recycled with the regularity of Bill Murray's time loop in Punxutawney, PA. Unfortunately, a news conference held by Secretary of Health and Human Services Secretary Kathleen Sebelius on October 14th, announcing the demise of the Community Living Assistance Services and Supports Act (CLASS) received little attention from either the print or broadcast media.

Should the end of CLASS have been a lead story? Perhaps I exaggerate. But its failure deserved as much attention as the winning couple on "Dancing with the Stars." Other than the economy or unemployment, it is hard to imagine a more pressing domestic issue than what is often referred to as "The Retirement Crisis." Millions of Baby Boomers are nearing retirement with relatively limited savings and a diminished pension funding. Public coffers are stretched thin and Social Security cuts—enacted and forthcoming—will exacerbate the situation. Long-term care is part of a policy mosaic that requires a candid assessment of what the public and private sectors bring to the solution, as well as soul searching about micro (individual) level behavioral changes related to our savings shortfalls.

The end of CLASS brings to the forefront a long list of challenges that the healthcare, insurance and human services sector will face in the coming years. These challenges require continued attention and public debate.

The following discussion underscores the FIU Metropolitan Center's commitment to informed public policy. My colleagues and I welcome your feedback. I can be reached at howardf@fiu.edu or (305) 779-7870.

Cordially,

Howard Frank, Ph.D.
Director, FIU Metropolitan Center

CLASS's passing received little attention in the media. This was surprising. In part, CLASS's demise may impact long-term budget projections used by the Obama administration (in theory, keeping seniors at home would have prevented higher outlays for institutional care). But from a broader vantage, CLASS's suspension underscores a deeply rooted retirement mess we collectively face, and how difficult it will be to address within an incremental framework.

CLASS would have provided enrollees with a $50 to $100 day benefit for at-home care—which is preferred by most seniors—after five years of premium payments, pegged at $25 to $334 a month depending on age. Unlike private long-term care (LTC) insurance, the only determinant of premiums was age. No other underwriting criteria were allowed under the enabling legislation. CLASS would have mirrored private-sector LTC by basing coverage on the six Activities of Daily Living (ADLs): cleaning oneself, dressing and undressing, feeding oneself, transferring out of bed or to and from the bathroom, "managing" bowel and bladder movements, and walking without cane/walker or requiring wheelchair, with a benefit trigger of 2+ ADLs lost and a benefit increment at 4+ ADLs.

Former Senator Judd Gregg of New Hampshire added language to the Health Care Reform Act that required CLASS to be solvent over a 75 year time frame. The private consultant hired to assess CLASS's financials concluded it could not pass actuarial muster. The culprit was "adverse selection," the same dilemma that has dogged private sector LTC offerings. In this context, adverse selection suggests that the policy would not appeal to younger, healthier beneficiaries and would instead appeal to older, sicker clients. This would lead to a "death spiral" in which premiums are raised to cover revenue shortfalls, which make the policies increasingly unappealing to healthier clientele—or unaffordable to current beneficiaries. This would require curtaining of benefits or premium subsidies. In the case of CLASS, the latter would mean adding to the federal general fund deficit. Per legislative intent, CLASS was to have been self-supporting through a standalone trust fund.

Some would argue that CLASS's downfall was a richly deserved kick in the ideological and fiscal solar plexus of "Obamacare." I would remind them that in 1986, Ronald Reagan and his Secretary of Health and Human Services, Dr. Otis Bowen, proposed a $59 a month Catastrophic Health Plan that would have limited annual-out-pocket expenses for Medicare beneficiaries to $2,000 and covered long-term care expenses. The Great Communicator and his HHS Secretary understood the significant LTC gaps in Medicare and their consequent private and public financial burdens. While subsequent changes to Medicare have increased drug coverage, LTC is still largely restricted to post-hospital stays and for short duration. This, despite the reality that seven out of ten aged 65+ will require some type of LTC, and nearly 50 percent of those requiring care will require at least one year of coverage; nearly 25 percent will require over three years. The ensuing financial burden often brings spend-down of household assets or assumption of cost via Medicaid. Thus in theory and practice, LTC would minimize asset spend down and decrease public outlays.

While there are no easy answers to the LTC challenges, the potential solutions lie in the continued discussion of different options.

1) LTC Will Require Hybridization to Grow

In theory, the private sector should play a critical role in pooling individual resources to meet LTC needs. In practice that has not been the case. Since its inception in 1987, LTC insurance has been purchased by only three percent of the population. Academic literature offers two explanations for this limited diffusion. The first is that individuals make a "die broke" decision (the title of a 1998 best seller) and spend down their assets (or those of immediate family or friends) to take care of LTC. Another school holds that in addition to their high cost, LTC policies are too complicated to understand and obligate would-be purchasers to make calculations about future earnings, savings, and inflation that are beyond the understanding of most Americans.

LTC has been nightmarish for insurers. Penn Treaty, once a darling of Wall Street as the only LTC pure play, is under receivership. As many senior Floridians know, Conseco (now CNO) was nearly bankrupted by its book of LTC policies that were grossly underpriced, and many policyholders were forced to accept steep benefit cuts and premium increases to maintain coverage late in life. MetLife, the nation's fifth largest issuer with over 500,000 LTC policies in force, stopped underwriting new policies at the end of 2010.

While overall LTC sales are a disappointment, there is growing demand for the LTC-life insurance hybrid. Distilled to their essence, these policies convert the face value of the death benefit into a "pool" of LTC funds if the need arises. Take, for example, a hybrid with a $150,000 death benefit. If $80,000 of LTC is utilized, $70,000 of death benefit remains. Some consumer advocates believe hybrids are less cost-effective than separate LTC and life insurance policies. But insurance executives believe these are the only vehicles that will attract younger clients, minimizing the adverse selection that has plagued LTC since its inception. Employers need to educate their workforce about these policies and incorporate them into their cafeteria-style offerings.

2) Popular and Academic Literature says we have a "Retirement Crisis:" What We Really Have is a Savings Crisis

The imploding defined benefit pension system, increasing longevity, and decreasing Social Security benefits are often cited as parts of the "Retirement Crisis. " While these factors are clearly present, I have argued for many years that this crisis is part of a far larger crisis—our low savings rate. Americans saved at a post-"Great Recession" peak of 6.2 percent in 2009, but this has skidded to 3.8 percent during the current holiday season. European saving rates are typically 15 percent; Asians routinely save upwards of 30-50 percent of their incomes. Over the past 25 years Americans have lost the saving habit. Indeed, we seem to take pride in the fact that 70 percent of our economy is consumer-based.

From my vantage, it will take a fundamental restructuring of our tax system to steer Americans into a higher savings rate. America is "exceptional" in many ways; the absence of a national consumption tax is one of them. For a host of reasons, I suspect a consumption tax will be on the table in the forthcoming presidential contest. And at the risk of sounding "Un-American," and certainly "Un-Floridian," we need to alter a tax code that anoints housing and real property as a privileged asset class. In sum, LTC and retirement savings represent delayed consumption that the tax structure does little to encourage, and we should consider if tax breaks directed to real property need re-direction.

3) We Have Too Many Retirement Accounts and Too Much Leakage

We have SEPs, Keoughs, Roth IRAs, Regular IRAs, 403s, 457s and 401ks…and others. In an era characterized by defined contribution pensions, this smorgasbord makes for a very complicated array that deters savings. More importantly, the absence of automatic rollover of these accounts from one employer to another causes leakage from retirement savings (i.e, workers tend to cash out at separation). Some have argued that the financial services industry prefers this plethora of accounts as a means of maintaining product differentiation and limiting direct cost and performance comparison.

It is time to consider creation of a generic retirement account when you are issued a Social Security number and have that account serve as your savings vehicle for life. Equally important, I would limit borrowing privileges to severe illness. If people want to save for housing or education—they should do so in separate vehicles. And in a country where savings is limited, the absence of automatic retirement savings rollover is critical.

4) It isn't STEM versus Liberal Arts; the Real Problem is Financial Illiteracy!

If we were to believe some elected officials, liberal arts training is fluff; science, technology, engineering, and mathematics (STEM) are what counts. From my vantage, this discussion overlooks a critical shortcoming of K-12 education: Most Americans graduate high school unable to balance a check book, obtain competing insurance bids, prepare a family budget, comprehend the impact of inflation on savings and earnings, or understand the importance of savings. In point-of-fact, Federal Reserve Chair Ben Bernanke has frequently stated our financial illiteracy is a drag on the economy because it leads to misallocation of savings and investment.

Financial literacy breeds financial self-efficacy, which in turn leads to improved outcomes in terms of retirement savings. This finding is universal across income, gender, and race. In a country that sees itself as the vanguard of capitalism, our financial illiteracy is astonishing and disturbing. If we want citizens to be increasingly self-reliant they need financial literacy early on. Changes in tax law and retirement savings accounts may help solve the so-called "retirement crisis," but understanding Capitalism 101 is a prerequisite.

CONCLUSION:

CLASS's end may have been justified on actuarial grounds. But its "passing" does not obviate America's increasing need for LTC. Writ large, we need to think about the incentives we establish for savings along the life trajectory. Indirectly, CLASS's passing raises a fundamental question: How does American reverse its high-consumption, low-savings stripes? Solving our seemingly intractable federal budget may provide some initial answers to that question.