

EXHIBIT P

Brown, Nicole (HHS/ASL)

From: Marton, William (HHS/ASPE)
Sent: Tuesday, December 01, 2009 1:50 PM
To: Squillace, Marie (HHS/ASPE); Katz, Ruth (HHS/ASPE); Frank, Richard (HHS/ASPE)
Subject: RE: CLASS



Appendix B.doc

Here is Appendix B...

Bill

From: Squillace, Marie (HHS/ASPE)
Sent: Tuesday, December 01, 2009 1:03 PM
To: Katz, Ruth (HHS/ASPE); Marton, William (HHS/ASPE); Frank, Richard (HHS/ASPE)
Subject: RE: CLASS

Here's the first pass. Bill needs to add Appendix B.

<< File: December 2nd Deliverable.doc >>

From: Katz, Ruth (HHS/ASPE)
Sent: Tuesday, December 01, 2009 1:01 PM
To: Squillace, Marie (HHS/ASPE); Marton, William (HHS/ASPE); Frank, Richard (HHS/ASPE)
Subject: RE: CLASS

Can you send it to us?

Earlier is fine with me, but marie b says there is no time on rf's calendar except for 4:30.

From: Squillace, Marie (HHS/ASPE)
Sent: Tuesday, December 01, 2009 11:52 AM
To: Katz, Ruth (HHS/ASPE); Marton, William (HHS/ASPE); Frank, Richard (HHS/ASPE)
Subject: CLASS
Importance: High

I've got the first pass on the Dec. 2nd CLASS deliverable complete if you want to meet earlier today.

Marie

Appendix B

Technical Comments on CLASS Legislation

Automatic Enrollment via Employers The Secretary, in coordination with the Secretary of the Treasury, is responsible for establishing procedures for individuals to be automatically enrolled in CLASS unless they choose to opt-out [Section 3204(a)(1)]. An underlying assumption is that employers who voluntarily participate in CLASS will deduct premiums from wages similar to the process for contributing to 401(k)s and 403(b)s (i.e., employees will be automatically enrolled in the program unless they waive enrollment and premiums deducted from paychecks accordingly). However, employer participation is likely to be very low for a number of reasons:

- Unlike payroll deductions for Social Security and Medicare that are a fixed percentage of earned income, CLASS premiums will vary by the employee's age, year of participation, and previous enrollment. Employers will not know *a priori* what the premium should be for participating employees. As a result, employers may be unwilling to participate in a program that is complex and requires substantial interaction with a third party administrator to effectively implement.
- The collection of premiums is a fiduciary responsibility that requires employers to accurately collect and transmit premiums to the government. Collecting premiums would require a nontrivial change to existing payroll systems and additional responsibilities that employers may be reluctant to take on.
- Even if the above technical issues could be resolved, employers may be reluctant to participate because employee interest in CLASS may be minimal. Current market penetration for private long-term care insurance is five to seven percent for policies aggressively sold through group plans. The low demand for long-term care insurance is primarily due to the public's lack of knowledge of the risk of long-term care and current pricing structure. Without a major education and marketing campaign to increase interest in CLASS, employee interest is likely to remain low and employers will not likely participate in a burdensome program that their employees do not value.

If employer participation is negligible, an alternative approach to automatic enrollment would be required. One possible alternative is to move to a "mandated offer" approach where employers over a certain size (e.g., 50 employees) would be required to offer enrollment. Under this scenario, employers would provide information to employees about CLASS and an enrollment form. Employees would return the form to their employer indicating whether or not they wished to participate in CLASS (or were already offered enrollment through another employer). The employer would then forward the information to the agency administering CLASS. At that point, the employer would be out of the equation; the employee would interact with the CLASS program directly to receive information, pay premiums, apply for benefits, etc.

Alternative Enrollment Procedures The Secretary is responsible for establishing an alternative enrollment procedure if an individual is either self-employed, has more than one employer, or if their employer does not participate in the CLASS automatic enrollment process [Section 3204(a)(2)]. Moving to a mandated offer approach addresses the issue of individuals working for large employers. For smaller employers and self-employed individuals, an alternative approach would be for the government to provide information and enrollment directly to eligible persons through electronic and other medium. For example, the government could establish a website and telephone hotline to market the program and serve as a conduit to individuals not connected to large employers.

Administrative Expenses The Senate bill states that administrative expenses cannot exceed 3% of all premiums paid during any year that the CLASS program is in effect [Section 3203(b)(2)]. The House bill allows for higher administrative expenses: 3% of all premiums paid during the first five years of the program [Section 3203(b)(2)(A)] and 5% of the total amount of all expenditures (including benefits paid) in subsequent years [Section 3203(b)(2)(B)]. The American Academy of Actuaries stated in a letter to the Senate Committee on Health, Education, Labor and Pensions that the proposed administrative expenses were too low because there would be significant start-up costs associated with marketing the program, collecting premiums, assessing eligibility for benefits and paying claims. The Academy noted that similar private programs have administrative expenses between 10% and 15% of premiums. Although this may be on the high end, administrative expenses for CLASS in the early years could easily exceed the amounts designated in the Senate and House bills. ASPE has analyzed aspects of the CLASS program and assumed that administrative expenses were 3% of premiums *plus* 5% of benefits. The administrative costs equal to 3% of premiums would cover marketing, premium billing and collection, and overhead; the 5% of benefits would be used for eligibility determination and claims payment and adjudication.

Minimizing Adverse Selection Because of the voluntary nature of the proposed CLASS program and lack of underwriting beyond issue age, it is critical to have as large a risk pool as possible to minimize adverse selection. The best way to get broad participation in CLASS is to aggressively market the program and establish as low an initial set of premiums as possible consistent with program solvency. The following changes to the CLASS legislation would significantly reduce premiums and therefore increase participation:

- Although both the Senate and House bills give the Secretary flexibility to change CLASS premiums to maintain adequate reserves and program solvency, the current legislative proposals assume an initial age-rated level premium, i.e., an individual's initial premium varies by age (younger persons pay less; older persons pay more), but remains constant over time. The initial premium could be substantially reduced beyond an age-rated level one if premiums are fully or partially indexed to the Consumer Price Index for all Urban Consumers (CPI-U). For example, if CLASS participation is 6% and premiums rise at 1.4% per year ($\frac{1}{2}$ the rate of price inflation assumed in the 2009 OASDI Trustees Report), the

initial premiums for a \$50/day benefit with a modest 6% participation would be reduced by about 14%; fully indexing the premium would reduce the initial premiums by approximately 26%.

- The Senate bill requires that an individual have approximately \$1,000 of earned income in at least three calendar years that occur during the first sixty months that an individual is enrolled in the program to be eligible for CLASS benefits [Section 3202(6)(A)(ii)]; the House bill requires approximately \$1,000 in earned income for each year of the sixty month period in order to be eligible [Section 3202(6)(A)(ii)]. Increasing the earnings requirement in the House legislation to \$1,000 per quarter (\$4,000 per year) would reduce the initial weighted average monthly premium for a \$50/day benefit by approximately 4%.
- Both the Senate and House bills require enrollees in CLASS to pay premiums for five years before being eligible for benefits. Assuming 6% participation in the CLASS program, increasing the vesting period by two years reduces the initial premiums by roughly 14% for a \$50/day benefit.

Changes to the Benefit Structure that Maximize CLASS Solvency Unlike most private insurance that reimburses policy holders for long-term care expenses, the CLASS benefit is a lifetime cash payment paid daily or weekly once a person meets the eligibility criteria of the program. The CLASS benefit is therefore more like a disability annuity, and enrollees have a great incentive to apply for benefits as soon as possible. The likely high demand will require a corresponding high premium structure, which could affect initial participation. The end result could be severe adverse selection that would in turn threaten the long-run solvency of the program. The American Academy of Actuaries has recommended several changes to the CLASS benefit to increase solvency:

- Adding an elimination (waiting) period to the CLASS program that would require beneficiaries to pay for services out-of-pocket before the government begins paying the daily or weekly CLASS benefit. An elimination period is similar to an insurance deductible and most private long-term care insurance policies have waiting periods from 60 to 120 days before reimbursing for long-term care expenses. An elimination period of 90 days would reduce premiums modestly.
- Reducing the duration of cash benefits from lifetime to a fixed set of years. According to a recent study, current cohorts of persons aged 65 will need approximately three years of long-term care over their lives (3.7 years for women, 2.2 years for men). If the CLASS benefit was six years in duration instead of lifetime, the initial weighted average monthly premium for a \$50/day benefit would decline by 19%. A time limited benefit would also reduce the demand for services as people would likely use their benefits more conservatively.
- Using the Health Insurance Portability and Accountability Act activity of daily living (ADL) triggers to improve consistency. Title 26, Section 7702B(c)(2) states that qualified long-term care insurance must include six ADLs (eating,

toileting, transferring, bathing, dressing, and continence) as possible triggers for benefits. Once an insured person has two or more ADL impairments (or severe cognitive impairment), he or she can file a claim for benefits. However, the Internal Revenue Code (IRC) allows insurance companies to use a shorter list of ADLs (specifically five instead of six) when determining eligibility and still have the policy considered qualified. The House version of the CLASS Act uses the IRC code to define ADLs [Section 3202(3)]; the Senate version simply lists them. However, neither version of the bills explicitly mentions whether the Secretary should use 2+³+ of five or six ADLs as the basis for determining benefits. Given the fact that incontinence is really a medical condition and likely overlaps somewhat with the toileting ADL, it would be useful for the Secretary to have the same flexibility in determining the list of ADLs as currently exists in the IRC for insurers.

- Moving from a cash benefit to one that reimburses based on service use. This recommendation would align the CLASS program to traditional private long-term care insurance, but clearly goes well beyond the intent of the current legislation. An alternative that still maintains the cash nature of the CLASS benefit is to require the use of fiscal management services similar to those incorporated into Cash and Counseling. Cash and Counseling offers Medicaid consumers who have disabilities more choices about how to get help at home. Specifically, it gives frail elders and adults with disabilities the option to manage a flexible budget and decide for themselves what mix of goods and services will best meet their personal care needs. Cash and Counseling program participants manage their cash benefits through financial management services (FMS) providers (also referred to as fiscal/employer agents, fiscal support entities, or fiscal intermediaries). Consumer-directed program participants develop written spending plans, which describe how they plan to use their funds to meet their disability-related service needs. Counselors work one-on-one (in-home and by telephone) to assist the program participant or a family member serving as his or her representative (similar to a Social Security "representative payee") to develop a service/spending plan that addresses his or her needs for paid services and supports. The counselor is not a case manager insofar as it is not his or her job to prescribe or authorize a plan of care for the program participant based on his or her professional judgment, but he/she may provide advice about appropriate services/providers if the program participant/family requests such advice. The program participant's monthly allowance may be prospectively paid to the FMS, in which case, there is a periodic "reconciliation" process and unspent funds are returned to Medicaid (or other public program). Alternatively, the FMS may pay the bills then submit claims for reimbursement to the public program retrospectively. Adding a fiscal intermediary to the basic structure of the CLASS program would ensure that funds are spent on appropriate social services and supports. The key, however, is to find a balance between CLASS beneficiaries' desire to have total control over their cash benefit, and developing and successfully implementing some type of fiscal management requirement that is more restrictive.

Change the Penalty for Reenrollment in CLASS Both the House and Senate legislation includes penalties for reenrollment after a 90-day period during which premiums were not paid. The penalties vary, however, depending if the reenrollment occurs within five years from the point that the enrollee last paid premiums. If the reenrollment occurs within the five year "window," the reenrollee would receive credit for prior months of payment, but would pay a higher age-rated premium in the future that is the same as that of a contemporary new enrollee [Section 3203(b)(C)]. If the reenrollment occurs five years after a participant last paid premiums, the re-enrollee would pay the prevailing age-rated premium increased by the greater of "(i) an amount that the Secretary determines is actuarially sound for each month that occurs during the period that begins with the first month for which the individual failed to pay the monthly premium required to maintain the individual's enrollment in the CLASS program and ends with the month preceding the month in which the reenrollment is effective; or (ii) 1 percent of the applicable age-adjusted premium for each such month occurring in the same period [Section 3203(b)(D)]." Administering a program whose premium structure changes by so many variables will be challenging, and likely confusing to employers, employees currently participating in CLASS, and potential enrollees/reenrollees. A simpler approach is to subject reenrollees to the prevailing set of age-rated premiums, but reduce their accrued months of payment toward meeting the five year vesting period by a fixed amount. For example, if every 90-day period of lapsed payment reduced the credited time by three months, a person who reenrolls in the program after five years would have to complete another five year vesting period before being eligible for benefits. The formula could be changed to provide more or less of a disincentive to lapse, but a simple penalty tied to the vesting period is certainly easier to explain, implement, and administer than one tied to premiums or the payment of a monetary penalty.