



Joint Economic Committee Republicans

Senator Sam Brownback *Ranking Member*
Representative Kevin Brady *Senior House Republican*

2 Unwinding Obamacare

Exploring the Democrats' 2,700-page, \$2.6 trillion takeover of health care

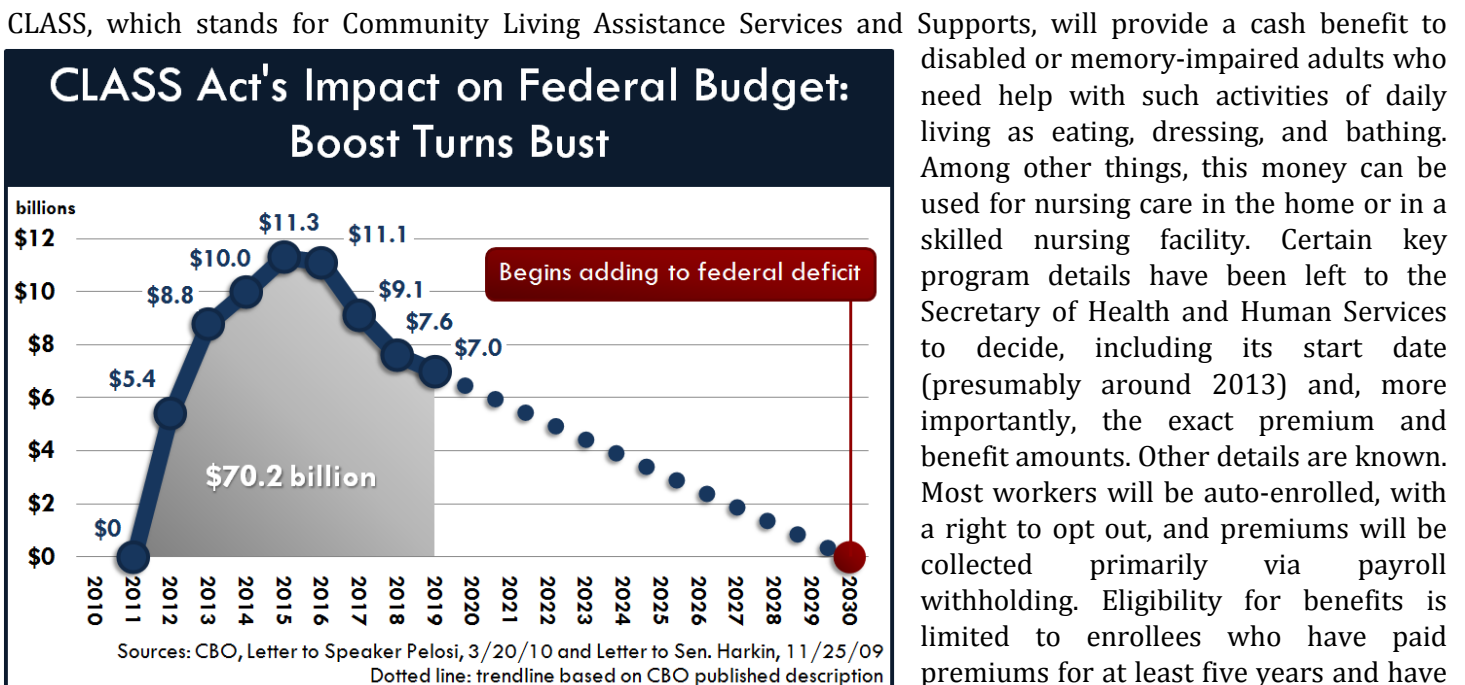
CLASS Act: Madoff Would Be Proud

May 18, 2010

Buried deep within the Patient Protection and Affordable Care Act is a little-noticed program called the CLASS Act. This new program will provide a cash benefit for certain disabled persons to help them with their long-term care needs—and will directly compete with existing private-market insurance offerings. Unlike other federal entitlements, CLASS is supposed to be voluntary and self-financing, with no federal subsidies. However, the program as currently designed is unsound and appears doomed to add to the federal deficit within the next 15 to 20 years. Taxpayer intervention will likely be needed.

A "Ponzi Scheme"

So alarmed by this prospect is Senator Kent Conrad (D-ND), chairman of the Senate Budget Committee, that he has publicly denounced CLASS as "a Ponzi scheme of the first order, the kind of thing that Bernie Madoff would have been proud of."¹ While Mr. Madoff's views on the CLASS Act are unknown (he is currently serving a 150-year sentence in federal prison for investment fraud), Sen. Conrad's concerns are justified.



- Obamacare includes a new long-term care entitlement called CLASS that masks health care reform's full costs.
- CLASS will add to federal deficits within 15-20 years.
- It is financially unsustainable due to poor design.
- Fixing it will require premium hikes, benefit cuts, and/or mandatory participation.

"We have to pass the bill, so that you can find out what is in it."

—House Speaker Nancy Pelosi

worked at least part-time for three of those five years. Premiums, which may vary only by age at enrollment, must remain level over time, and will be capped at a nominal \$5 for the poor and full-time college students. There is a benefit floor of \$50 a day. The Congressional Budget Office assumes average benefits will be about \$75 a day.² By comparison, most private offerings pay benefits of \$120 to \$400 a day, with the average being \$165.³

A “Gimmick”—and a “Very Serious Risk”

Although CLASS involves no federal subsidies, it is a federal program, administered by the Secretaries of HHS and Treasury. All of its financial operations will be included in the federal budget. Since no benefits will be paid during its first five years, CLASS will initially improve the federal balance sheet, by an estimated \$70.2 billion over its first decade.⁴ That, of course, is why congressional Democrats included it in their bill—to help make Obamacare seem less costly than it is. However, these “savings” will later have to be paid out again as cash benefits. As the chart shows, CLASS’s positive effect on the budget will decline after 2015, when benefits start. By 2030, projected costs will exceed premium revenues, causing the CLASS trust fund to add to federal deficits. Although the law requires the HHS Secretary to raise premiums each year as necessary to keep the trust fund solvent over the subsequent 75 years, Medicare’s Chief Actuary, Richard S. Foster, believes “there is a very serious risk that the problem of adverse selection will make the CLASS program unsustainable”—a view shared by the nation’s leading actuarial societies.⁵

Inherently Unstable

CLASS practically invites adverse selection, the bane of poorly designed insurance schemes, because it is voluntary, open to all, and yet permits premiums to vary only by age. This differs from how things work in the private market, where although anyone may buy long-term care insurance, applicants who are more apt to need care due to age, health history, or current medical conditions are charged a higher premium to reflect their relatively higher risk level. When premiums can vary only by age, relatively healthy, low-risk people will not buy the insurance, and the cost of insuring the remaining, higher-risk population will rise. If CLASS is truly self-financing, the Secretary will have to keep raising the premiums, because only high-risk individuals will choose to be insured. This will be sustainable only so long as the premiums remain lower than those of private-market alternatives for persons with the same risk level. Congress has made the Secretary’s job difficult here, however, by capping premiums for poor people and undergraduates and exempting certain retirees from premium hikes; which means the Secretary must set higher premiums for all other enrollees. Even high-risk participants who might prefer to remain in CLASS will opt out once they realize they can obtain similar coverage for a lower cost in the private market. CBO estimates only 3.5% of the adult population, or 10 million people, will enroll by 2019. The current participation rate for private long-term care insurance offered through employers, with no auto-enrollment, is 4%.⁶

If the Secretary fails to raise premiums sufficiently, Congress will be forced to step in. It could raise premiums further, reduce benefits, or restrict eligibility—or even make participation mandatory. The latter option is not altogether improbable, given how adamant congressional Democrats have been that Obamacare must be mandatory—to avert adverse selection. Should Congress fail to reform the program, its only way to avert insolvency will be a taxpayer bailout. CLASS cannot be voluntary, self-sustaining, and a good deal for workers and taxpayers, all at once. Something, or rather someone, will have to give.

Conclusion

As currently designed, CLASS will not be able to sustain itself without subsidies from taxpayers or from all workers in the form of mandatory enrollment. In addition to being unsound, the program is unnecessary. Americans already have an array of private long-term care insurance options to choose from: many are more economical than CLASS, most offer richer benefits. The best remedy for the unsustainable, unaffordable CLASS program is to repeal it.

¹ *Washington Post*, “Proposed long-term insurance program raises questions,” 10/27/09.

² CBO, Letter to Speaker Pelosi, 3/20/10.

³ American Academy of Actuaries and Society of Actuaries, Joint letter on CLASS Act, 7/22/09, http://www.actuary.org/pdf/health/class_july09.pdf.

⁴ CBO, op. cit. The Medicare Agency, CMS, projects a much lower \$38b in savings. CMS, “Estimated Financial Effects of [PPACA],” 4/22/10.

⁵ AAA and SOA, op. cit.

⁶ CBO, Letter to Sen. Harkin, 11/25/09. CMS’s Foster projects enrollment of only 2% of the eligible population by 2013. CMS, op. cit.