Reading Between the Lines:

A deeper dive into the differences between LTC and Chronic Illness Riders

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The differences between long-term care (LTC) riders and chronic illness riders have been a subject of confusion for many advisors and other industry professionals wanting to feel more secure in their knowledge and ability to offer solutions that will meet their client's expectations at claim time. In the past, one of the main differentiators was that a claim under a chronic illness rider required the insured to be certified that *"care services will likely be needed the rest of the insured's life"* – or in other words – the condition had to be deemed non-recoverable. While there are other important differences, including whether the rider benefit amount is determined at policy issue, or whether the rider will discount benefits at claim time; the one difference that was easy to understand was the non-recoverable requirement consistent with chronic illness riders; but that has now changed.

The Interstate Compact is a group comprised of most but not all states; who have agreed to a unified set of standards for approving insurance products. Effective as of December 2014, the Interstate Compact revised standards for chronic illness riders, which receive tax favored treatment as an accelerated life insurance benefit under Internal Revenue Code §101(g). The new standards now allow for approval of chronic illness riders that include the option of paying temporary chronic illness claims. Keep in mind these revised standards provide the option to include benefit triggers for temporary claims, but it is not a requirement.

This recent change however, may have actually blurred the lines even more between chronic illness riders and LTC riders. While some people may believe this change in standards helps bring chronic illness riders closer to the level of LTC riders, there is also a blinding blur that needs to be clarified because there is much more that differentiates the two products – and these differences largely center on the methods of paying benefits and important consumer protections. This paper will focus on:

- refreshing the reader on the methods of underwriting and charging for riders, how benefits are calculated, and the effect the rider has on death benefits
- describing important policy features required of LTC riders but not required of chronic illness riders – and the impact to a policy owner's benefits.

Digging deeper through the differences

Long-term Care Riders

LTC Riders are generally easy to understand and provide the client the knowledge that 100% of policy benefits will be paid in some manner, temporary LTC claims can qualify for benefits, and consumer protections are built into the policy as required by regulations. These policies generally work as follows:

- A percentage of the death benefit is accelerated each month to provide LTC benefits. The percentage amount varies by company, but is generally between 1% and 4% per month and the available benefit amount is known at issue. The entire death benefit is usually made available for acceleration and 100% of the death benefit is paid.[1]
- As required by IRC Section §7702B, claims are paid whether the qualifying event is temporary in nature or permanent. The insured must meet one of the required triggering events – by either being unable to perform 2 Activities of Daily Living (ADLs)[2] without assistance or suffering from severe cognitive impairment. It must be certified by a U.S. licensed health care practitioner that the condition will last at least 90 days, and an individualized plan of care must be submitted with the claim. The insured must also meet any policy requirements stated in the contract such as elimination periods, etc.
- LTC riders are underwritten separately from the policy and rider costs are included in policy charges. Because of this, the insurance company is able to determine at policy issue and communicate to the policy owner the amount of the monthly LTC benefit.
- LTC rider benefits are paid per the **dollar for dollar reduction method**. This means that for each dollar paid in LTC rider benefits, the death benefit is reduced by one dollar. 100% of the death benefit amount stated at issue is what will be paid, either as LTC benefits, death benefit to beneficiaries, or a combination of both.[3]

Chronic Illness Riders

The conscientious advisor will want to be aware of several differentiating features when ascertaining whether a chronic illness rider will meet client needs. Currently, most insurance companies require the insured's condition to be non-recoverable; but insurance companies are now beginning to offer chronic illness riders that pay temporary claims as long as the base regulatory requirement is met that a condition will last at least 90 days.

In addition, advisors will need to keep track of how each company they sell product through handles underwriting, rider charges, calculation of benefits and the effect the discounted chronic illness benefits have on total benefits paid from the policy. More detailed information can be found by requesting the white paper *"Understanding the Variations between Long-term Care and Chronic Illness Riders"* form NFM-10801AO.4.

The following are some initial points an advisor should be looking for when reading a chronic illness rider contract of a product he or she is considering for showing client:

1. Does the chronic illness rider require the claim to be permanent?

The definitions page will not likely contain all the information or requirements needed to ascertain claim qualifications, but often will only state the regulatory definition of chronic illness. You may likely have to look at the section of the contract pertaining to filing a claim to discover whether a permanent condition (likely to last the rest of the insured's life) is required, whether there are any other limitations to claims, and other requirements that will need to be met for a claim approval.

2. Is the chronic illness rider underwritten and charged for?

If so, benefits are generally paid by the dollar for dollar method. Thus, each dollar paid in chronic illness benefits will reduce the death benefit by one dollar. The death benefit amount issued is what will be paid in its entirety, either as chronic illness benefits, death benefit to beneficiaries, or a combination of both (assuming no withdrawals or loans were taken).

[1] Assuming no withdrawals or loans were taken from the policy.

[2] Activities of daily living include bathing, dressing, eating, transferring, toileting and continence

[3] Assuming no withdrawals or loans were taken from the policy.

3. Does the rider tout "no charge" and "no underwriting"?
If so, the chronic illness rider benefits will be paid by one of two actuarial methods that charge for the rider on the back end.

a) The **discount method**. The chronic illness benefit is calculated at claim time, and is based on the following data existing at time of claim – age of insured, their gender, cash value in the policy, and the discount interest rate – as well as the rate class the insured was issued at. The policy language may state the benefit is "up to 24% of the death benefit each year" – but the key language to watch for is "up to". What this means is, the formula will discount the chronic illness benefit received based on the acceleration amount, but the benefit will never exceed 24% of the death benefit in a year's time. In reality, what is received will likely be less – maybe much less - unless the insured is near age 100 at claim time. Any amount of accelerated death benefit not paid is permanently forfeited as the charge for the rider. Unless the insured never uses rider benefits, or is around age 100 when invoking the rider, the policy will not pay 100% of the death benefit amount stated at issue. This method may not work well for a client's strategy because neither the chronic illness benefit nor the remaining death benefit can be determined until time of claim.

b) The **lien with interest method**. The chronic illness benefit is known at issue and is usually the lesser of: 50% of the death benefit or $250,000. A lien is placed on the remaining death benefit with an interest rate that is set at claim time. The accrual of interest over time will erode the remaining death benefit. Therefore, it will not be known how much death benefit will be left - if anything - to pay beneficiaries until death of the insured occurs. For claims lasting only a few months, the reduction of the death benefit would be minimal; however, for claims lasting several years the reduction in death benefit may be quite noticeable. A $500,000 policy accelerating $250,000 for chronic illness benefits at a 5.50% discount interest rate would see little or no death benefit remaining if the claim were to last 12 to 13 years.

The Importance of Consumer Protections

Methods of paying benefits and determining whether a chronic illness rider will pay on a temporary claim are important to ascertain. But there is much more to look at.

What are "consumer protections"?
LTC Riders on life insurance have mandatory built in features that are required of all traditional LTC policies or riders on any type product sold as "long-term care insurance" coverage. Currently, Alzheimer's disease and dementia are the leading cause of a LTC claim for people over the age of 65.[4] Consumer protection provisions provide important solutions that protect policy owners from situations that may unintentionally arise due to a physical or cognitive incapacitation, resulting in an individual's LTC coverage being put in jeopardy. These provisions help protect the consumer from an unintended policy lapse, and even possible loss of benefits on an already lapsed policy.

These same consumer protections are not required of chronic illness riders, so without careful reading of the specific terms of the chronic illness contract intended for purchase, one can not be sure if some or any consumer protections are included with the policy.

Consumer protection features to watch for
The following is a description of consumer protection features that can make a real difference in protecting the ability for claims payments to be received if ever needed. This is not a complete list of LTC consumer protections, but rather, protections that specifically help protect the policy from unintended lapse or the insured from loss of benefits.

[4] The American Association of Long Term Care Insurance, Sourcebook 2015-2016

Unintentional Lapse

All LTC policies and LTC riders are required to have this feature.

- The *unintentional lapse* feature requires that the insurance company provide the opportunity for the policy owner to set up an authorized representative (third party contact). If the policy is in danger of lapse, notice must be sent to the policy owner and their authorized representative (if one is assigned) within 30 days of lapse to inform them that the policy is in danger of lapse and premium needs to be paid to keep the policy in force. The opportunity to assign an authorized representative must be offered to the policy owner at policy issue and every two years thereafter. This feature does not guarantee the policy will not lapse, but rather is meant to help prevent unintended lapse due to a policy owner's functional incapacity or a cognitive reason that leaves them unable to pay premium.

Chronic Illness riders are not required to offer this feature. The consequences of not having an unintentional lapse feature on a policy could potentially be further compounded by the following two features that are also not required on a chronic illness rider.

Reinstatement provision

All LTC policies and LTC riders are required to have this feature.

- The *reinstatement provision* on a LTC policy or LTC rider has more liberal standards than the reinstatement provision of a life insurance policy. Under the reinstatement provision of a LTC policy or LTC rider, reinstatement must be available for a period of time <u>without any evidence</u> of insurability. The reinstatement must be requested within five months of the date of policy termination and reasonable evidence must be shown that the insured either had a functional incapacity or a cognitive reason for being unable to pay the premium due that would have kept the policy in force. As part of the reinstatement procedure, premiums will need to be paid and the policy brought back into good order. Upon reinstatement requirements being met, the policy is considered back in force with all rights and provisions available. Interestingly, when a LTC rider is added to a life insurance policy, the strict requirements of the reinstatement provision of the life insurance policy are softened by the more liberal standard required of the LTC rider – which is a positive benefit to the policy owner.

Chronic Illness riders, which are governed by life insurance regulations, are not required to offer the same standards for reinstatement required of a LTC policy or LTC rider. Thus you will want to carefully check the terms of the chronic illness rider contract to see if the reinstatement provision of the rider is tied to the more stringent reinstatement provision of the life insurance policy. If so, the provision will allow for the reinstatement of a terminated policy and the attached chronic illness rider, but only <u>with new evidence of insurability</u>.

The potential danger of a reinstatement provision requiring evidence of insurability is that if the policy unintentionally lapses due to the insured having functional incapacity or a cognitive reason, it may also result in the insured being unable to pass underwriting requirements needed to show evidence of insurability. Therefore the policy and chronic illness rider would remain lapsed.

Extension of Benefits

All LTC policies and LTC riders are required to have this feature.

- The *extension of benefit* provision is a protection that allows for LTC benefits to still be paid if the insured can prove he or she would have qualified for benefits prior to the date their policy was terminated. When a LTC rider is added to a life insurance policy, this provision allows the policy owner to go back and capture LTC benefits the insured would have qualified for on their policy if they had applied for their rider benefits while the policy was still in force. The policy is still considered lapsed for purposes of the death benefit; therefore the only benefits that will be paid are the LTC benefits the insured would have qualified for prior to the termination of the policy.

Chronic Illness riders are not required to offer this feature. Thus, if the insured would have qualified for chronic illness rider benefits prior to policy lapse, would be no contractual right to recapture benefits.

How benefits are paid

While many advisors are aware of the different payment methods of rider benefits on life insurance, a brief refresher is shown below,[5] including defining the difference between indemnity and cash indemnity.

- *Reimbursement policies* – require bills and receipts to be submitted to the insurance company each month. The plan will only cover specific qualified LTC expenses, and the policy owner (or the facility or care service) will only be reimbursed for the exact amount of qualifying expenses up to the maximum benefit amount. There is never any benefit dollars received in excess of actual qualifying expenses, even if expenses are less than the policy's maximum monthly benefit amount. Any remaining unused LTC benefits are paid as a death benefit.

- *Indemnity policies* – will pay the entire maximum monthly LTC benefit amount. Some policies will tie the maximum amount that can be received in some manner to the Health Insurance Portability and Accountability Act (HIPAA) per diem in the year of claim. Most policies of this type require a certain level of licensed care services be used. However, any LTC benefits received that are not needed to pay for care services can be used to meet any other individualized needs of the insured, or can be set aside for LTC expenses that may occur after all LTC benefits have been received in full. Any remaining unused LTC benefits are paid as a death benefit.

- *Cash indemnity policies* – will pay the entire maximum monthly LTC benefit amount. Some policies will tie the maximum amount that can be received in some manner to the HIPAA per diem in the year of claim. The insurance company places no restrictions on how LTC benefits are used; thus benefits can be used to pay family members or less expensive informal caregivers to provide care. LTC benefits received that are not needed for the individualized needs of the insured can be set aside for LTC expenses that may occur after their LTC benefits have been paid in full. Any remaining unused LTC benefits are paid as a death benefit.

- *Acceleration* – is the method used by chronic illness riders, and has the look and feel of indemnity. The entire qualifying benefit amount is received based on the type formula the policy uses to calculate benefits (dollar for dollar method, discount method, or lien with interest method). Some policies will tie the maximum amount that can be received in some manner to the HIPAA per diem in the year of claim. Any remaining unused LTC benefits are paid as a death benefit.

[5] These benefit payment methods are in regard to LTC and Chronic Illness Riders on life insurance only and may or may not apply as written in this article to traditional LTC policies or linked benefit LTC coverage.

Differences at a glance

The purpose of the chart below is to provide an advisor a quick glance of features and benefits offered by each type LTC or chronic illness rider. This chart does not include all features or benefits an insurance company may offer, but does provide a starting point to help an advisor sift through policy rider details he or she may be considering as solutions for a specific client's financial strategy.

	Dollar for Dollar LTC Rider	Dollar for Dollar Chronic Illness Rider	Lien with Interest Chronic Illness Rider	Discounted Chronic Illness Rider
Internal Revenue Code Section	7702B[6]	101(g)	101(g)	101(g)
Pays Permanent Claims	YES	YES	YES	YES
Pays Temporary Claims	YES	Most still NO but varies by company, check policy details[7]	Most still NO but varies by company, check policy details[7]	Most still NO but varies by company, check policy details[7]
Method of benefit payment	Indemnity or Reimbursement	Acceleration	Acceleration	Acceleration
Actual LTC or Chronic Illness claim benefit is known at policy issue	YES	YES	YES	NO
Total pay-out from policy known at issue (Rider benefits plus remaining DB)	YES	YES	NO	NO
100% of policy death benefit collected if rider is invoked prior to age 100	YES	YES	NO	NO
Residual Death Benefit Paid	YES on most[8]	NO	NO	NO
Unintentional Lapse Protection	YES	Not required	Not required	Not required
Reinstatement within 5 months of termination	YES	Not required	Not required	Not required
Extension of Benefits	YES	Not required	Not required	Not required
Life Insurance and other license required[9]	YES	YES	YES	YES
State specific LTC CE requirements needed	YES[10]	None	None	None

[6] Most LTC riders are filed in this manner, however there are a few companies that file LTC riders under IRS Code §101(g) paired with NAIC LTC Model Regulations. These products may be referred to a long-term care and have the same consumer protection requirements as do LTC Riders filed under IRS Code § 7702B

[7] Please refer to the insurance company's rider contract in the section on claims for specific details

[8] Please refer to the insurance company's rider contract for details on availability and amount of any residual death benefit offered.

[9] Some states require health insurance. In addition, there may not be other underlying licenses needed to sell the base life insurance policy

[10] Most states (but not all) have a minimum LTC CE requirement that must be maintained in order to sell LTC Riders or any LTC product.

Summary

In the end, the client's best interest should always be of first consideration when helping a client choose a solution for potential long-term care or chronic illness needs. When showing a LTC or chronic illness rider to a client purchasing life insurance, the following check list should be covered and discussed.

- What triggering conditions are covered under the policy?
- Are temporary claims included?
- How are rider benefits calculated?
- How are rider benefits paid to the policy owner?
- Are there policy protections to help avoid unintentional lapse of the policy?
- Do the reinstatement provisions of the rider require evidence of insurability?
- Are there provisions contained in the rider to pay deserved benefits even if a policy unintentionally lapses (extension of benefits)?

Making sure your client understands the LTC or chronic illness coverage they are purchasing will potentially lead to a better experience for all if and when a claim eventually arises.

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