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Understanding Variations in Long-term Care and Chronic Illness Riders

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America is aging. The Baby Boomer generation - once our nation's largest group of youth – now adds to the population of retirees at a rate of 10,000 people per day[1]. With the impending expansion of the elder population, long-term care (LTC) continues to escalate in importance as a segment of financial and retirement planning.

There was a time when the only way to insure the risk of long-term care expenses was through a traditional stand alone long-term care policy. While a variety of features are offered that allow customization such as inflation protection and a variety of benefit periods, some consumers have become apprehensive to purchase these products due to the possibility of the"use it or lose it" nature of such policies (especially with no return of premium feature). In addition, companies have been raising rates to policy holders - and this isn't just a one time rate increase – it could continue to happen throughout the life of the stand alone long-term care policy. Other solutions needed to be developed to make LTC insurance purchases more attractive to consumers.

Modernizing LTC Solutions
A new way to insure long-term care was developed using permanent life insurance as a base and allowing the policy holder to accelerate the death benefit to pay for qualifying LTC expenses. This modern version of LTC coverage accomplishes several things that now make planning more palatable to the consumer.

- The "use it or lose it " objection often associated with stand alone policies is eliminated since any benefit not needed for LTC needs will be paid as a death benefit to the beneficiaries
- Premiums can be guaranteed when choosing guaranteed death benefit products
- Life insurance has a new use in retirement– living benefits that help pay expenses when LTC needs arise – providing an additional reason to purchase permanent life insurance

These products have become extremely popular and are seeing a rapid growth in sales – up 38% in 2011[2] - while sales of traditional LTC policies have been stagnant at best with a -5% compound annual growth rate between 2005 and 2010[3]. Seeing this opportunity, more and more life insurance companies have been adding riders to their product line up. But with this mass addition of riders, confusion abounds. While various companies may appear to offer essentially the same protection, there are many differences the advisor should be aware of.

Rider Classifications and Differentiators – What This Means to a Client
All life insurance riders paying benefits for chronic illness do so via 101(g), as this allows the benefit to be paid as a tax free acceleration of death benefit. However, that's where the similarities among all LTC/chronic illness products end. The purpose of this article is to explain the differences in how a rider is classified. These differentiators determine what type claims qualify for benefits, how benefits are paid out, and how these riders are charged for. Understanding these differences is extremely important so an insurance professional can present a client with a clear picture of what they are actually purchasing.

Long-term Care Riders – classified as 7702B

Riders with the additional classification of 7702B offer more comprehensive coverage. To qualify for claim, the client needs to meet the basic definition of chronic illness, which requires a physician to certify the insured - for a period of at least 90 days - is unable to perform at least two Activities of Daily Living (ADLs) or suffers from severe cognitive impairment. This definition allows for the LTC condition of the insured to eventually be fully recoverable, so conditions such as mild strokes, orthopedic repairs, side effects of certain cancers, etc. would qualify for a long-term care claim on this type of policy. In addition, all riders in this category charge an additional fee for the rider, which will add to the policy premium cost. LTC monthly benefits and cumulative total benefits are determined at issue (assuming no withdrawals or loans from the policy) so the policy holder knows from day one what the benefits will be should they need to go on claim.

Indemnity vs. Reimbursement

The main differentiator among 7702B long-term care riders is whether the rider pays by an Indemnity or Reimbursement model.

Reimbursement plans – Regardless of what the stated maximum benefit is, reimbursement plans will never pay more than the qualifying LTC expenses incurred. Qualifying expenses in reimbursement plans do not include the costs of home modification, medical equipment (i.e. walkers), nor other potential expenses that go along with LTC needs. Bills and receipts must be accounted for every month. Some carriers will allow the service or facility to bill the insurance carrier directly and will make direct payment back to the facility. Other carriers may require the policy holder to submit the bills each month, and then wait for reimbursement of expenses. Either way, it's possible for a service to be billed for that may not be covered by the policy. In that event, the policy holder will have to pay for the ineligible service out of pocket. However, some people may like this plan because when bills are less than the stated benefit, only the amount covering the qualifying costs will be paid, thus providing automatic potential to stretch out the LTC benefit for a longer period of time.

Indemnity plans - This type plan will pay the maximum benefit the policy allows, regardless of what the LTC expenses are. While some plans may require a licensed service to be involved in the care, no bills or receipts are needed to justify the cost of care. However, keep in mind there are a few companies offering an indemnity payout that call for monthly re-verification of services by requiring copies of bills be submitted to prove continued use of a licensed provider (full benefits are still paid). While the entire benefit is available on an indemnity plan, some people may prefer to take only what they need to extend the benefit period.

Indemnity plans allow for a wide array of flexible solutions because excess benefits not needed to pay for care can be used for any purpose. A client could use excess benefit funds to:

- purchase medical equipment or pay deductibles or medical bills not covered by other sources
- upgrade the home with safety and accessibility features to remain safely in the home longer
- hire help the keep the home clean and maintained
- help pay costs of a spouse who also has LTC needs (insured needs to be on claim at the time)

Because full benefits are paid to the contract owner, an indemnity LTC rider can also be used in other planning opportunities such as:

- adding the LTC rider to policy used in an ILIT (irrevocable life insurance trust)
- adding the LTC rider to a Buy/Sell Agreement or Key Person policy to help supplement the life insurance in non-death situations

Chronic Illness Riders – Classified only as 101(g)

Some riders are classified as 101(g) only and are generally referred to as "Accelerated Death Benefit for Chronic Illness" riders. With these products, the term "long-term care" may *not* be used in marketing, sales literature, or in sales presentations to clients. The term "chronic illness" must be used instead. In addition, these riders generally require that the physician must certify the chronic illness *"is likely to last the rest of the insured's life"*. In other words, the condition must be non-recoverable. Conditions such as mild to moderate strokes, orthopedic repairs, physical complications from cancer recovery, and other recoverable conditions, would not be eligible to go on claim. For this reason, particular care should be taken when explaining these products to clients so they have a thorough understanding of any limitations in coverage. These riders all use the indemnity model since claims reimbursement is not possible due to not being a long-term care product.

Additional Charge for Rider vs. Discounted Acceleration of Death Benefit

A differentiator among Chronic Illness Riders is whether the rider is paid for by an additional charge added to the policy (which would increase the premium requirement),or, by including the rider as a policy feature, then discounting the amount of death benefit accelerated to provide the chronic illness benefit if necessary.

Discounted Acceleration - Some companies "include" the Chronic Illness Rider feature as part of the policy at no additional charge. But keep in mind "no charge" does not equate to "free". Instead of charging for the rider as part of the cost of insurance, these riders discount the acceleration of death benefit when the rider is actually needed. Because of this, benefits can not be determined until the time comes to go on claim. The discounting of the benefit is based on several variables including age, sex of the insured, premium class, as well as interest rates and policy cash values at time of claim. The younger you are when filing a claim, the more the death benefit is discounted - ultimately reducing the amount of total benefits paid out. Women, with all other factors equal, will have a larger discount factor than men, and thus receive less benefit. It is important to explain to clients choosing this type plan that neither the Chronic Illness benefit amount nor the total benefit pool available can be predicted in advance, but rather, can only be determined at time of claim. While some may argue this method spares people who never experience chronic illness expenses from having to pay rider charges, those needing benefits may not understand at the time of claim why the policy death benefit is not worth what is was at policy issue. One company providing this type product offers the example that a 70 year old making an election of the rider would be subject to a discount of around 30%*. On a $400,000 policy, the potential result of collecting for a chronic illness (assuming the entire allowable amount was accelerated), plus the final amount held back to be paid at death, would be a net total of approximately $273,000. While some companies will accelerate benefits on a monthly basis, others require the discounted acceleration to be paid annually or semi-annually. The design of this type rider offers minimal risk to the insurance company.

Additional charge to cost of insurance- Other Chronic Illness products assign a cost of insurance to the chronic illness rider and take monthly deductions from policy values – essentially the same way the base policy is charged for. While this does increase the premium for the overall life insurance policy, charging for the rider up front provides a client with the advantage of knowing from day one exactly what was purchased and how much chronic illness benefit they will be entitled to, no matter when the need arises. Clients wanting clarity in what they purchased may find the additional charge minimal in comparison the potential loss of benefits created by the discounting method.

The following chart summarizes rider categories and features described in this article.

<table>
<tr><th colspan="2">Long-term Care Rider/product</th><th colspan="2">Accelerated Death Benefit for Chronic Illness Rider</th></tr>
<tr><td colspan="2">Section 7702B</td><td colspan="2">Section 101(g)</td></tr>
<tr><td colspan="2">May be marketed verbally and in writing as long-term care coverage</td><td colspan="2">May NOT be marketed in any manner as long-term care coverage</td></tr>
<tr><td colspan="2">Pays temporary and permanent claims</td><td colspan="2">Only permanent conditions will qualify for claim (certified condition must be likely to last the rest of the insured’s life)</td></tr>
<tr><td colspan="2">State specific Long-term Care CE may be required to sell these products
(not all states require this and it varies based on product design and state specific regulations)</td><td colspan="2">No Long-term Care CE is required to sell these products because they are not considered long-term care products</td></tr>
<tr><td colspan="2">Has potential for a residual death in excess of original specified amount**</td><td colspan="2">There is no residual death benefit in excess of original death benefit amount. Some companies require a portion of the death benefit to be held back to be paid upon death</td></tr>
<tr><td colspan="2">Has additional cost of insurance charge for rider. LTC benefit pool and monthly benefits are determined upfront and specified at policy issue***</td><td colspan="2">All are indemnity since claims reimbursement is not possible.</td></tr>
<tr><th colspan="2">Differentiators of 7702B products</th><th colspan="2">Differentiators of 101(g) Products</th></tr>
<tr><th>Indemnity</th><th>Reimbursement</th><th>Additional charge for rider</th><th>Included with policy but discounts the acceleration of death benefit</th></tr>
<tr><td>Full benefit is paid regardless of what the actual LTC expenses are. Excess benefits can be used for any other purpose.</td><td>Only the actual costs of qualifying long-term care services are reimbursed.</td><td>Has an additional cost of insurance charge for rider.</td><td>Rider included with policy. Upon applying for claim, factors such as age, sex of the insured, premium class, as well as cash value and interest rates at time of claim are used to discount the death benefit to be accelerated</td></tr>
<tr><td></td><td></td><td>The Chronic Illness benefit pool and monthly benefits are determined upfront and are specified at policy issue**</td><td>Total Chronic Illness benefit pool and benefit amount can not be determined until time of claim. Some companies pay a monthly benefit while others accelerate on an annual or semi-annual basis.</td></tr>
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Summary

There are numerous solutions available today for insuring against long-term care and chronic illness expenses. In addition to traditional LTC products, riders on life insurance open new possibilities for clients looking to find a solution that meets their budget and concerns. It is important the insurance professional thoroughly understand and be able to explain how each of the plans work, including the advantages and disadvantages of each plan, so client’s will be able to make a informed choice for a solution they understand and will be comfortable with.

Please keep in mind that many of the products mentioned in this article require separate underwriting and that a long-term care rider or chronic illness rider can be table rated or declined while still approving the base life insurance policy.

*This example was provided by a company's brochure offering this style chronic illness rider
**This feature can vary widely among companies.
***This assumes no withdrawals or loans are taken from the policy. Taking withdrawals or loans will result in a reduction of the benefit pool for LTC or Chronic Illness benefits, and with some companies, may also cause a reduction of the monthly amount originally specified. See specific company for details.

[1] CBS, Los Angeles – "Expert Advice for Baby Boomers on Planning Health in Retirement", April 14, 2012
[2] LIMRA 2011 Annual Review – Life with LTC Riders and Chronic Illness Riders
[3] The 2011 Sourcebook for Long-term Care Insurance Information – AALTCI 2011

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