Understanding the Differences Between Long-term Care Riders and Chronic Illness Riders

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Some Things You Should Know

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- Investing involves risk, including possible loss of principal
- Keep in mind that as an acceleration of the death benefit, the LTC rider payout will reduce both the death benefit and cash surrender values. Care should be taken to make sure that your clients' life insurance needs continue to be met even if the rider pays out in full. There is no guarantee that the rider will cover the entire cost for all of the insured's long-term care as these vary with the needs of each insured.

Some Things You Should Know

- When evaluating the purchase of a variable annuity, your clients should be aware that variable annuities are long-term investment vehicles designed for retirement purposes and will fluctuate in value; annuities have limitations; and investing involves market risk, including possible loss of principal.
- This information assumes that the life insurance is not a modified endowment contract, or MEC. As long as the contract meets the non-MEC definitions of IRC Section 7702A, most distributions are taxed on a first-in/first-out basis. Surrender charges may apply to partial surrenders. Loans and partial surrenders from a MEC will generally be taxable, and if taken prior to age 59 ½, may be subject to a 10% tax penalty. Loans and partial surrenders will reduce the cash value and the death benefits payable to your beneficiaries, and withdrawals above the available free amount will incur surrender charges. If your contract were to lapse with a loan outstanding, the loan amount in excess of basis will be treated as a distribution and all or a portion will be subject to income tax.
- The underlying investment options to a variable annuity or life insurance product are not publicly traded mutual funds and are not available directly for purchase by the general public. They are only available through variable annuity/variable life insurance policies issued by life insurance companies.

Some Things You Should Know

- As your clients' personal situations change (i.e., marriage, birth of a child or job promotion), so will their life insurance needs. Care should be taken to ensure these strategies and products are suitable for long-term life insurance needs. You should weigh your clients' objectives, time horizon and risk tolerance as well as any associated costs before investing. Also, be aware that market volatility can lead to the possibility of the need for additional premium in the policy. Variable life insurance has fees and charges associated with it that include costs of insurance that vary with such characteristics of the insured as gender, health and age, underlying fund charges and expenses, and additional charges for riders that customize a policy to fit your clients' individual needs.
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• Not a deposit • Not FDIC or NCUSIF insured • Not guaranteed by the institution
• Not insured by any federal government agency • May lose value

Life Insurance/Combo policies

Classification of rider determines:

- How product can be marketed
- Requirements needed to sell a product
- How rider is charged for
- How claims are paid
- Effect on the base policy death benefit

Tax qualified Status

"Tax Qualified" LTC Riders

- Favorable federal tax treatment under IRC Section 7702B
- Can be marketed as a qualified LTC contract
- Covers temporary and permanent claim conditions
- Majority of states have long-term care CE requirement
- Some states require a health license
- Riders are underwritten and charged for
  - Use the Dollar for Dollar reduction method
- LTC benefits determined at policy issue
- At least 100% of issued amount is paid regardless of when LTC claim takes place (assuming no withdrawals or loans)

Tax qualified Status

Chronic illness riders

- Favorable federal tax treatment under IRC Section 101(g)
- Strictly prohibited from being marketed as long-term care*
- Most still require certification that the insured's condition will likely last their lifetime is generally required
- Interstate compact now allows new filings to cover temporary claims but most filings are still using permanent requirement
  – New rules do not grandfather to currently filed products
- Currently, there are no CE requirements
- Actuarial Methods of paying benefits vary
  - Some use the Dollar for Dollar reduction method
  - Many use the Discount Method or Lien with Interest Method

*Some states, for state purposes only, consider these LTC products, but for federal purposes they are not.

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New Regulations add to Confusion

- The Interstate Compact revised standards for Chronic Illness Riders were put into force December 2014.
- New standards allow Chronic Illness Riders to be filed with ability to pay temporary claims
- This is an option, not a requirement

Long-term Care rider claims

- Claims lasting 90 days or more

Chronic Illness rider claims

- Most still require the insure be “likely to need care the rest of their life”
- Some will pay for claims lasting 90 days or more

Effect of the **Dollar for Dollar Method**

- Used primarily by LTC Riders, and a few Chronic Illness Riders
- Fully underwritten (may offer table ratings) and charged for
  - Monthly benefit amount and total benefit pool remain constant
- A percentage of death benefit available each month for LTC
  - 2% per month most common (50 month benefit)
  - Each dollar of benefit reduces death benefit dollar for dollar

$400,000 policy/$400,000 LTC Rider – claim in policy year 22

Claim Year	Death Benefit/LTC Beginning of Yr.	LTC Monthly Benefit	Annual LTC Payout	Total LTC Benefit Paid	Remaining Death Benefit	Cumulative Total Paid
1	$400,000	$8,000	$96,000	$96,000	$304,000	**$400,000**
2	$304,000	$8,000	$96,000	$192,000	$208,000	**$400,000**
3	$208,000	$8,000	$96,000	$288,000	$112,000	**$400,000**
4	$112,000	$8,000	$96,000	$384,000	$16,000	**$400,000**
5	$16,000	$8,000	$96,000	**$400,000**	$0	**$400,000**

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Effect of the Discount Method

- No underwriting - available to all (included with policy)
- “No Charge” does not equate to free
- Death benefit is discounted at time of acceleration of benefits
  - Age, gender, rate class, cash value, discount interest rate
- Acceleration of DB not paid as Chronic Illness benefit is forfeited*

Age at Election	Death Benefit	C.I Benefit Amt Elected for Male	Death Benefit Male Forfeited	C.I Benefit Amt for Female	Death Benefit Amt. Female Forfeited
70	$100,000	$65,266	**$34,734**	$56,665	**$43,335**
75	$100,000	$71,868	**$28,132**	$63,651	**$36,349**
80	$100,000	$78,755	**$21,245**	$71,515	**$28,485**
85	$100,000	$84,562	**$15,438**	$79,147	**$20,853**

* Insured must be in general range of age 100 before full benefits would likely be paid. Numbers from company issuing this type product. Assumptions are a $500,000 policy with $50,000 of cash value, 7% interest rate at election . Election is 20% of death benefit $100,000.(maximum election 24%)

Effect of **Lien Method**
(with interest)

- No underwriting - available to all
  (may be limited to certain rate classes)
  - No Charge does not equate to free
- Lump sum benefit
  - Lesser of 50% of DB or $250,000
  - Subject to tax if exceeds IRS formula
- Interest charged on acceleration
  - Backed by lien on remaining DB

Hypothetical example:

- Policy Face Amount - $500,000
- Percentage Elected – 50%
- Accelerated Amount - $250,000
- Paid as lump sum to policy owner
- Rate for Payments – 5.50%

Years After Election	Lien with interest	Final Death Benefit
After Election	$250,000	$250,000
1	$263,750	$236,250
2	$278,256	$221,744
3	$293,560	$206,440
4	$309,706	$190,294
5	$326,740	$173,260
6	$344,711	$155,289
7	$363,670	$136,330
8	$383,672	$116,328
9	$404,774	$95,226
10	$427,036	$72,964
11	$450,523	$49,477
12	$475,302	$24,698
13	$501,443	-$1,443 (terminated)

Numbers and assumptions from company issuing this type product

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Long-term Care Rider (IRC 7702 B)	Chronic Illness Rider/ Accelerated Death Benefit
IRC 7702B (or LTC Model Regulations)	**IRC 101(g) only**
May be marketed verbally and in writing as long-term care coverage	May NOT be marketed in any manner as LTC coverage –must be referenced as chronic illness rider
Pays temporary and permanent claims	Generally, most companies require the condition to be certified as permanent to qualify for claim. A few companies allow temporary claims, so please refer to the contract for details.
State specific Long-term Care CE as well as a health license may be required to sell these products– varies by state.	No Long-term Care CE is required as these products are not considered long-term care. Health license may be required.
Has potential for residual death benefit in excess of original specified death benefit amount. (This feature may vary widely among companies)	No residual death benefit is paid in excess of original death benefit amount. Some companies limit acceleration so that a portion of death benefit can be held back and paid upon the death of insured
May pay benefits through indemnity or reimbursement since these are Long-term Care products. LTC benefits generally paid as monthly.	Paid by acceleration, which is “indemnity-like”. Claims reimbursement not possible since not a LTC product. Benefits paid monthly, quarterly, semi- annual or annual payment, or one total lump sum.
LTC rider is underwritten and has an additional cost of insurance charge for rider. LTC benefit pool and monthly benefits are determined upfront and specified at time of policy issue. (Assumes not withdrawals or loans taken which will result in a reduction of benefits)	Some plans underwrite, charge for rider, and determine benefits at issue. Other companies include the rider with the policy and either discount benefits at time of claim, and/or death benefit upon death of the insured.

Long-term Care Rider, cont.

Differentiators of LTC Products

Indemnity **(charge and underwrite)**		**Reimbursement** **(charge and underwrite)**	
Full benefits paid with no regard to actual LTC expenses. Generally, insurance company does not place any restrictions on how excess benefits can be used. Dollar for Dollar Method used to pay benefits. All benefits known at issue		Only the actual costs of qualifying long-term care services are reimbursed, capped at the maximum monthly LTC benefit amount. Dollar for Dollar Method used to pay benefits. All benefits known at issue.	
No monthly receipts or bills to submit. With **Cash Indemnity**, the insurance company places no restrictions on benefit use.	Monthly proof of billable expenses required each month to receive benefits.	Some carriers will do direct billing from the provider to the Ins. Co.	Bills and receipts submitted by policy owner – then reimbursed qualifying expenses

Accelerated Death Benefit for Chronic Illness Rider, cont.

Differentiators of 101(g) products

Additional charge for rider	**No Rider Charge. Rider benefit or DB adjusted**
The rider is fully underwritten. There is an additional cost for the rider, which will increase the premium cost. The Dollar for Dollar Method is used to pay benefits. All benefits known at issue.	These policies rarely pay in total the issued amount of insurance. Discount Method – Usually no underwriting for the rider. Factors at claim time such as age, gender, rate class, cash value & discount interest rates are used to discount benefits to be accelerated. Death benefit amount subtracted from acceleration as discount is permanently forfeited. Lien Method- final DB is determined at death subtracting lien on DB.
The Chronic Illness benefit pool and monthly benefits are determined upfront and are specified at policy issue.	Discount Method – C.I. benefit pool and benefit amount *cannot be determined* until time of claim. Lien Method – C.I. benefit known at policy issue, but final death benefit *cannot* be determined until death occurs and lien is subtracted from remaining death benefit.

The Importance of Consumer Protections

- LTC specific consumer protections
  - Are required on all LTCi and LTC Riders
  - Are NOT requires on Chronic Illness riders
- Cognitive Impairment – such as Alzheimer's and dementia, is the leading cause of LTC claims over age 65[1]
- Consumer protection features include:
  - Unintentional lapse protection
  - Reinstatement provision
  - Extension of benefits provision

[1] American Association of Long Term Care Insurance – AALTCI Sourcebook 2015- 2016

Reinstatement Provisions ……..

- LTC Rider policy reinstatement provisions
  - Good reason must be shown why premium could not be paid to keep policy inforce – does not need to meet full LTC claim standard
  - Leaves door open for full policy reinstatement for 5 months
  - No evidence of insurability can be required
  - LTC Riders tie the base policy to this same more liberal standard
- Chronic Illness Rider reinstatement provisions
  - Only required to offer same standards as base policy
  - New evidence of insurability would be required to reinstate policy
  - If new insurability does not exist – policy remains lapsed

Extension of Benefits Provision……

- LTC Rider extension of benefits provision
  - Good reason must be shown why premium could not be paid to keep policy inforce – does not need to meet full LTC claim standard
  - Leaves door open indefinitely to capture LTC benefits the insured would have qualified for while the policy was in force
  - LTC benefits are paid in arrears and until policy is exhausted or death occurs
  - Policy is still in lapsed status- no remaining death benefit paid

- Chronic Illness Rider not required to have feature
  - Once the policy is lapsed – it is lapsed
  - No chronic illness benefits can be recaptured
  - No death benefit is paid

………In Summary

Make sure your client understands:

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

Understanding these provisions will help provide a better experience if a claim is ever arises

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