



FOR FINANCIAL PROFESSIONAL USE ONLY – NOT FOR PUBLIC DISTRIBUTION.



TAKING AN IN-DEPTH LOOK:

LONG-TERM CARE RIDERS VS. CHRONIC ILLNESS RIDERS

Taking an In-Depth Look:
Long-Term Care Riders vs.
Chronic Illness Riders

Contents

- 03 Long-Term Care Benefits
- 06 Reimbursement
- 07 Indemnity
- 10 Consumer Protection Features
- 12 Discounted Death Benefit Method
- 13 Lien Method
- 14 Dollar-for-Dollar Acceleration Method
- 15 Waiver of Monthly Deductions/Premiums



Most of the baby-boom generation is on the precipice of retirement, and some people born after 1946 have already left the workforce. In 2011, the first of the baby boomers reached what used to be known as normal retirement age. The baby boomer generation began retiring earlier this decade, and the expectation is that roughly 10,000 boomers will exit the workforce each day between now and the end of next decade.¹ This generation not only faces the challenges associated with saving money for retirement, but also managing future healthcare costs as well. Boomers may need funds for long-term care services at some point and may find themselves with insufficient insurance coverage or personal savings to pay the bills.

Did you know that an average couple that retires at age 65 today should expect to spend, on average, \$260,000 for out-of-pocket medical expenses during their retirement years?²

So how can retirees protect themselves against the risk of not having enough money to pay for long-term care services at some point in their lives? Traditionally, they could purchase a stand-alone long-term care policy. But before we define how that type of contract works, let's first discuss what long-term care means. LongTermCare.gov defines long-term care as a range of services and supports someone may need to meet his or her personal care needs. Most long-term care is not medical care, but rather assistance with the basic personal tasks of everyday life, sometimes called activities of daily living.

These include:

- **Eating**
- **Toileting**
- **Transferring**
- **Bathing**
- **Dressing**
- **Continence**

Other common long-term care services and supports are assistance with everyday tasks, sometimes called instrumental activities of daily living, including:

- **Housework**
- **Managing money**
- **Taking medication**
- **Preparing and cleaning up after meals**
- **Shopping for groceries or clothes**
- **Using the telephone or other communication devices**
- **Caring for pets**
- **Responding to emergency alerts such as fire alarms**

Now that we've discussed what qualifies as long-term care, let's talk about how it's provided. The U.S. Department of Health and Human Services states that long-term care services and support typically come from:

- An unpaid caregiver, likely a family member or friend
- A nurse, home health or home care aide, and/or therapist who comes to the home
- Adult day care services in the area
- A variety of long-term care facilities

TAKING AN IN-DEPTH LOOK: LONG-TERM CARE RIDERS VS. CHRONIC ILLNESS RIDERS

You may be wondering how these services are typically paid for; informal care from family and friends make up the bulk of care (especially among the elderly), while Medicaid/Medicare provide the majority of funding for paid care. There are four main financing options that can be used to pay for long-term care services: self-funding, government programs, long-term care insurance and charity. Let's hone in on government programs and long-term care insurance, as self-funding and charity are self-explanatory. Long-term care expenditures are primarily paid for through government programs, which are both state and federally funded via Medicare and Medicaid.

Most of the money provided to pay for long-term care services is supplied by Medicare and Medicaid. Medicare was not specifically designed to cover long-term care needs and does not pay for any care services provided specifically for activities of daily living or instrumental activities of daily living. However, it does cover some post-acute care services, though with very limited coverage and strict eligibility requirements.

On the other side of the coin there is Medicaid, which is a joint federal and state program. Therefore, the eligibility requirements and long-term care coverage may vary by state. Requirements for Medicaid include low-income and asset level tests. In order for your clients to qualify, they may have to first spend down a percentage of their assets.

If Medicare and Medicaid are not the most viable options, what are some better solutions? Let's get back to the traditional stand-alone long-term care

policy. With this type of plan, clients pay a premium and receive benefits when qualified expenses occur. Long-term care contracts utilize the two of six activities of daily living or severe cognitive impairment as a benefit trigger.

This simply means that if insured persons are unable to perform two of the six activities of daily living, or if they suffer from a severe cognitive impairment, they will qualify for benefits. Additionally, the condition must be expected to affect the insured for at least 90 days. With a long-term care policy, those covered by the policy are supported throughout the healing process and are able to apply for more funding at a later date. This means a long-term care contract can cover both short-term as well as long-term conditions. We will discuss short-term vs. long-term conditions a little later.

Long-term care insurance premiums have seen significant increases since 2000. In fact, many companies have restricted their offerings and pulled out of the long-term care insurance business completely. Lately, there have been many factors impacting the LTC market. Let's look at a few major influences:

- **Use-it-or-lose-it nature:**
Consumers are more hesitant about paying for a product they may not use, especially with a budget limit.
- **Rising life expectancy and health care costs:**
Consumers are living longer and are more likely to use long-term care.

- **Long-term care costs are rising along with average medical care expenses:**

Private nursing home rooms now come with a median annual bill of \$92,378, an increase of 1.2 percent from last year and nearly 19 percent since 2011. That's roughly twice the rate of overall inflation and breaks down to a monthly bill of \$7,698.³

- **Prolonged low interest rate environment:**

Insurers need a 10 to 15 percent increase in premiums to offset every 1 percent decline in long-term interest rates.

Some insurers drop benefits to keep the same premiums.

Because of the market pressures listed above, insurance companies began searching for new ways to provide long-term care protection that extends beyond a typical stand-alone LTC policy. This ushered in the development of life combination products, which are life insurance policies with either chronic illness riders or long-term care riders.

However, there are no marketplace standards in place for these riders. As such, they have differing design characteristics as well as naming conventions. This can make it difficult for consumers to understand the pros and cons of the various options. Before we compare and contrast these types of riders, it's important to discuss two key design components of these products: reimbursement design and indemnity design.



Reimbursement

- Reimbursement products provide a benefit if the client meets the requirements of the policy and spends money on a qualified service.
- The upside of a reimbursement product is that clients receive a benefit equal to their total cost, up to a predetermined maximum.
- The downside is that there is a delay between when expenses are incurred and when the Insured gets paid. The Insured has to incur the expense, then collect and submit the receipt, then the carrier reviews and approves the receipts and finally issues the payment.

Indemnity

- Indemnity products are those that provide clients with a benefit once they meet the requirements of their policy.
- The advantage of an indemnity rider/product is that it does not require clients to provide proof that their benefit spending is related to the chronic condition. Therefore, the client can use the benefit to pay medical or nonmedical expenses, or to enhance his or her savings.

The distinctions between these two products are very important. The indemnity design is the more adaptable of the two options and can provide the client with flexibility. Did you know that the vast majority of people - 4 in 5, or 75 percent live in private homes where about 70 percent of the care is provided by family and friends?⁴

An indemnity plan is advantageous because funds from the policy can be accessed for ANY need, without receipt, once the insured person is certified as qualifying for coverage. For example, if a family member has to stop working to take care of his or her loved one, the monthly benefit can be used to help compensate the caregiver and help cover any expense, including, but not limited to: mortgage payments, utilities, phone bill, home repairs or modifications, housekeeping, etc.

With an indemnity design, the insured must only prove qualification for the benefit before the claim can be made, which initiates benefit payments without having to submit proof of services. With reimbursement plans, receipts must be reviewed, and sometimes payments can only be made directly to the care provider. Additionally, with an indemnity design, the insured receives the full monthly benefit as long as he or she qualifies.

With reimbursement riders, only the expenses incurred each month are paid, meaning an insured person who does not incur expenses that total up to his or her monthly benefit may not receive the maximum monthly benefit.



TAKING AN IN-DEPTH LOOK: LONG-TERM CARE RIDERS VS. CHRONIC ILLNESS RIDERS

Below is a table that compares a few of the design differences between a chronic illness rider and a long-term care rider.

FEATURE	Chronic Illness Rider	LTC Rider
Diagnosis	Severe cognitive impairment or unable to perform 2+ ADLs	Severe cognitive impairment or unable to perform 2+ ADLs
Duration	At least 90 days. Most riders require the condition to be permanent but some do not.	At least 90 days
Payment Types	Indemnity	Reimbursement or Indemnity
Benefit Types	Face amount acceleration	Face amount acceleration
Benefit Payments	Tax favored if meet IRS per diem requirements (Current maximum of \$360 per day for 2017)	Tax favored if meet IRS per diem requirements (Current maximum of \$360 per day for 2017) Also can be tax favored above stated per diem limits if proof is provided that the dollars were spent on qualified services related to the condition.
Other Features	May waive all policy monthly deductions while on claim	LTC riders are required to have an extension of benefit provision which would allow for benefits to still be paid even if the policy had lapsed if the insured can prove he or she would have qualified for benefits prior to the date their policy was terminated.
Licensing Requirements	Life Licensed Agents can sell*	Requires A&H license & LTC certification depending on state

* CA may require additional licensing & education requirements

TAKING AN IN-DEPTH LOOK: LONG-TERM CARE RIDERS VS. CHRONIC ILLNESS RIDERS

One main difference, often discussed in the industry, is permanent vs. non-permanent requirements. Some examples of short-term, non-permanent conditions include: broken bones, heart attack, fractures and minor strokes. Although these conditions require a certain degree of medical care, most of the time Medicare will partially cover the short-term hospital care and services, while family and friends pay for the remaining short-term care until the insured person fully recovers. However, it is not these short stays that consume most of the financial resources - it is the stays that require people to remain in facilities or receive care for years. Many clients who purchase a life insurance policy have enough savings to pay for short-term expenses not covered by Medicare or Medigap.

On the other hand, there are true long-term conditions. Some examples include: Alzheimer's disease, certain types of cancer, serious stroke, brain injury and many more. These are conditions that people need to be insured against to combat the rising cost of long-term care. Such illnesses can last for many years and place a significant strain on an individual's finances. Additionally, veritable long-term conditions can greatly impact family members and friends, which is why being able to access flexible funds, like those available through the indemnity options, is so vital. According to the AARP, the "average" caregiver is a 49-year-old woman who works outside the home and spends nearly 24 hours per week (which is slightly more than a half-time job) providing unpaid care for nearly four years.⁵ Advisors need to make sure that their clients have a long-term care plan, whether it is government funded, self-funded or covered under long-term care/chronic care insurance.

There have also been recent changes in the industry that have affected the design of chronic illness riders. Historically, most chronic illness riders offered have required that in order to activate the chronic illness rider, and accelerate the death benefit, an insured had to be unable to perform 2 of the 6 activities of daily living (eating, toileting, transferring, bathing, dressing, continence) or suffer from a severe cognitive impairment. Most riders also required that the condition be permanent, meaning the insured was not going to recover from their condition as determined by a licensed health care practitioner. This "permanency" requirement is not part of the Internal Revenue Code, IRC § 7702B and § 101 (g), that set forth the requirements around the design of a chronic illness rider. Instead, the permanency requirement was a condition of the Interstate Insurance Product Regulation Commission (IIPRC), sometimes referred to as the Interstate Compact. This commission serves as a central point of electronic filing for certain insurance products, including insurance, annuities, disability income, and long-term care insurance.¹ The permanency trigger still exists under C(1)(e)(i), but as a result of updated IIPRC standards, the definition of a qualifying event was revised to add a second alternative definition under C(1)(e)(ii) of "chronic illness". Because of these changes some companies have decided to take advantage of this most recent chronic illness rider definition which does not require permanency.²

1) <http://www.insurancecompact.org/about.htm>

2) Society of Actuaries, April 2015, Report on Life and Annuity Living Benefit Riders – Considerations for Insurers and Reinsurers, Friedrich, FSA, MAAA

Consumer Protection Features

Another design aspect to be aware of when comparing LTC riders and Chronic Illness riders relates to what are sometimes referred to as Consumer Protection features. These features are certain contractual provisions that can help prevent a policy from lapsing due to missed payments or allow for reinstatement. The concern here is that the exact time an individual needs to activate these riders will be the same time they may be suffering from a severe cognitive impairment, like Alzheimer's, and remembering to pay a life insurance premium might result in an issue.

Because of specific regulations around LTC rider designs these types of products are required to have consumer protection provisions. Chronic Illness Riders are not required to include these but some do. So it is very important to know whether or not the chronic illness rider you are using has these provisions or not.

Unintentional Lapse Provisions:

The unintentional lapse provision is designed to protect individuals who may develop a cognitive impairment and unintentionally allow their policy and rider to lapse due to non-payment of premium. The provision allows the policyowner to designate that a notification be sent to someone other than the insured if there are payments missed which in turn puts the policy in danger of lapsing.

Reinstatement Provisions:

Most life insurance contracts have what are referred to as reinstatement provisions. Which are rules that stipulate how and for what reasons a policyowner is allowed to reinstate their policy if it had unintentionally lapsed. The concern here is that if the policy lapsed because the insured was suffering from a severe cognitive impairment and did not pay the required premium the policy would no longer be available to provide the LTC or Chronic Illness benefits at the very time when they are needed the most. Normally, to reinstate a policy after it has lapsed, the insured would need to go through the underwriting process again. The reinstatement provision in an LTC rider or Chronic Illness rider would allow the policyowner the ability to reinstate their policy without having to go through the underwriting process again. There are also other considerations, like a time limit, as well as proof that the condition was the reason behind the policy lapse that are normally also required.

TAKING AN IN-DEPTH LOOK: LONG-TERM CARE RIDERS VS. CHRONIC ILLNESS RIDERS

Now that we've described the basic differences between long-term care and chronic illness riders, let's turn our attention to the different types of chronic illness riders. From an industry standpoint, there are currently three different chronic illness rider designs: **I. Discounted Death Benefit Method**, **II. Lien Method**, and **III. Dollar-for-Dollar Acceleration Method**. For each design, we'll compare three questions:

- Does the client have to pay up front?
- Does the client know the monthly benefit he or she can get when he or she goes on claim?
- Does the client know how much of the death benefit he or she will receive if he or she goes on claim?



I. Discounted Death Benefit Method

The first design we will look at is the discounted death benefit method. With this design, clients can accelerate all or part of their death benefit following diagnosis of a chronic illness. The no-cost accelerated benefit payout that results from a client's chronic illness is based primarily upon a factor related to the change in his or her insurer's expectation of his or her mortality since the time he or she acquired the coverage. If the client has a significantly shorter life expectancy due to the chronic condition, he or she will receive a larger payout. If his or her life expectancy is moderately impacted, then it will be a smaller payout. Depending on the carrier, clients may accelerate up to 100 percent of the policy death benefit up to a lifetime maximum.

With this design, clients can accelerate all or part of their death benefit following certification of a chronic illness.

Let's walk through an example - a hypothetical representation for illustrative purposes only:

Mr. Able, age 50, purchased a \$500,000 life insurance policy that offered chronic illness protection via the discounted death benefit method. Ten years later, at age 60, he experienced a stroke and was unable to perform two of the six activities of daily living. Prognosis for recovery was not good and the medical costs associated with this event were substantial. To help cover these expenses, he decided to accelerate \$100,000 of his \$500,000 policy. At the time of claim, the company determined the benefit and made an offer of \$44,888 based on the severity of the condition and revised life expectancy. He accepted the offer and received \$44,888. His policy's death benefit was reduced by the full \$100,000 acceleration to \$400,000.

Let's see how the discounted death benefit fits with the three fundamental questions:

- Does the client have to pay up front? **NO**
- Does the client know the monthly benefit he or she can get when he or she goes on claim? **NO**
- Does the client know how much of the death benefit he or she will receive if he or she goes on claim? **NO**



II. Lien Method

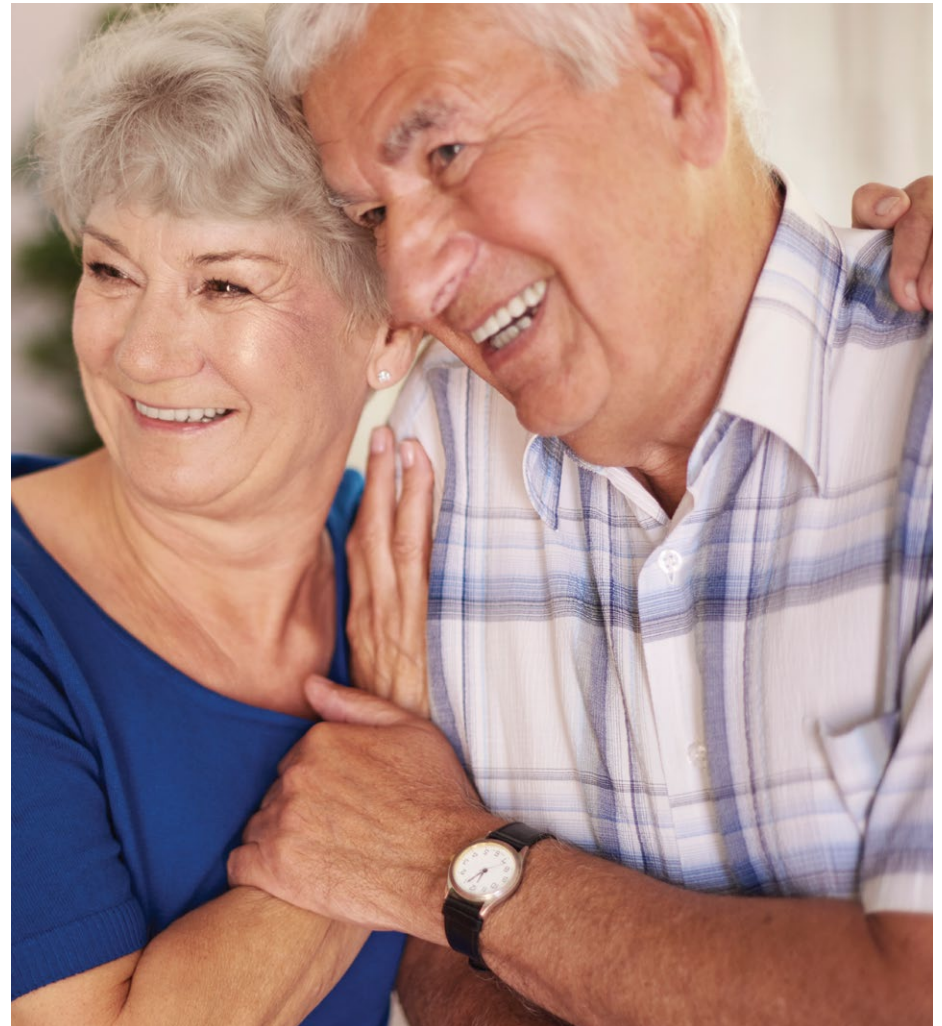
Next, let's look at the lien method design. With this chronic illness rider, the client isn't charged until he or she uses the benefit. Clients can accelerate a portion of their death benefit in the form of a lien against the policy if they're diagnosed with a chronic illness. The no-cost accelerated benefit payout is based on a formula linked to the death benefit or net amount at risk, which applies a factor that can vary based on the insured person's age at the time of claim. The lien interest rate is set when the benefit is enacted and is typically based on market rates. The policy must continue to be kept in force. There is a risk that there may be a lapse in coverage if the lien plus interest exceeds the death benefit. Now we'll circle back to the three main questions:

- Does the client have to pay up front? **NO**
- Does the client know the monthly benefit he or she can get when he or she goes on claim? **NO**
- Does the client know how much of the death benefit he or she will receive if he or she goes on claim? **NO**

III. Dollar-For-Dollar Acceleration Method

The third and final design is perhaps simplest to explain and understand. With the dollar-for-dollar acceleration method, the cost of adding chronic illness coverage to an existing policy is blatant. When a client becomes chronically ill, there is a dollar-for-dollar acceleration of the death benefit. As an example, if a client had purchased a \$500,000 life insurance policy and added a dollar-for-dollar acceleration chronic illness rider, he or she would be able to accelerate his or her entire \$500,000 death benefit and be paid dollar-for-dollar. Note that depending on the carrier, there may be a maximum amount of death benefits that can be accelerated when employing this design. As you consider this payment option, let's review the core questions.

- Does the client have to pay up front? **YES**
- Does the client know the monthly benefit he or she can get when he or she goes on claim? **YES**
- Does the client know how much of the death benefit he or she will receive if he or she goes on claim? **YES**



Waiver of Monthly Deductions/Premiums

It is essential that you are aware of these distinct features and benefits if you're working on a long-term care plan with clients.

Understanding the differences between chronic illness rider designs and LTC rider designs is crucial in selecting the appropriate product for your clients.

Another key aspect to review with clients is what happens to the policy after you go on claim.

Will the policy owner still be required to pay premium?

With the recent change to the design of some chronic illness riders not requiring the condition be permanent it is imperative that you become aware of what happens if the insured comes off claim in the future.

Riders that do not waive charges (unless the policyholder continues to pay policy premiums while on claim) may owe all the missed charges assessed during the claim. This happens because policy owners who do not pay the required premiums might have a lapsed policy following the end of the claim. Therefore, they could be faced with a very large premium to keep the policy in force, particularly in a GUL, where the timing of premium payments can have a significant effect on the overall cost.

It is imperative that you familiarize yourself with how the products you offer your clients that deal with owed premiums. For example, did you know that there is a feature that waives all policy charges while the insured is on claim?

As you can see, there are many nuances to these different designs. It is essential that you are aware of these distinct features and benefits if you're working on a long-term care plan with clients. Understanding these products can set you apart from other financial professionals and arm you with the information needed to improve service and results. Depending on each client's goals, objectives and budget concerns, you can help determine which option is best for that individual. American General Life Insurance Company is here to assist you with any questions in regard to this topic. Please reach out to your American General Life Insurance representative with any further questions or concerns.

To find out more...

Speak to your American General Life Insurance representative about how life insurance can help you plan for the unexpected.

Policies issued by American General Life Insurance Company (AGL) except in New York, where issued by The United States Life Insurance Company in the City of New York (US Life). Issuing companies AGL and US Life are responsible for financial obligations of insurance products and are members of American International Group, Inc. (AIG). Products may not be available in all states and product features may vary by state.

©2017 AIG. All rights reserved.

AGLC108647 REV0517

FOR FINANCIAL PROFESSIONAL USE ONLY - NOT FOR PUBLIC DISTRIBUTION

For Educational Purposes Only.

The Company, its financial professionals and other representatives are not authorized to give legal, tax or accounting advice. Applicable laws and regulations are complex and subject to change. Any tax statements in this material are not intended to suggest the avoidance of U.S. federal, state or local tax penalties. For advice concerning your situation, consult your professional attorney, tax advisor or accountant.





Sources:

1. <https://www.fool.com/retirement/general/2016/05/15/baby-boomers-retirement-woes-summed-up-in-5-stats.aspx>
2. <https://www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise>
3. <https://www.usnews.com/news/business/articles/2016-05-10/study-long-term-care-costs-continue-to-rise>
4. <http://www.prb.org/pdf16/TodaysResearchAging33.pdf>
5. http://www.caregiving.org/wp-content/uploads/2015/05/Caregiving-in-the-US-2015_Typical_CGProfile.pdf

