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Understanding the 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 – is now moving into retirement. 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 insurance (LTCi) policy. While a variety of features are offered that allow customization to these policies, including inflation protection and a choice of benefit periods; some consumers have become apprehensive to purchase these products largely due to the possibility of a “use it or lose it” scenario (especially with no return of premium feature). In addition, companies have been raising rates to LTCi policy holders - and while new policies have been priced with considerations of low interest rates and gender specific claims experience, there is still no guarantee that the premium will remain the same amount throughout the life of the policy. For some people, the initial lower overall cost and ability to customize the policy justified the risk of possibly never collecting benefits, but other solutions needed to be developed to make LTC coverage more attractive overall 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 some consumers.

- The “use it or lose it” objection often associated with LTCi policies is eliminated since any benefit not needed for LTC needs will be paid as a death benefit to the beneficiaries
- Premiums and benefits can be guaranteed when choosing guaranteed death benefit policies
- 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; while the traditional LTC marketplace struggles to overcome clients concerns with price hikes and companies getting out of the business. 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 important differences between LTC Riders and Chronic Illness Riders to consider.

Rider Classifications and Differentiators – What This Means to a Client

The purpose of this paper is to explain the differences in how a rider is classified. These differentiators determine how the riders are charged for - what of type claims qualify for benefits - how benefits are paid out - if the benefit amount is known at issue and guaranteed - and how much the acceleration and

final death benefit in total the policy will pay. Understanding these differences is extremely important so an insurance professional can present a client with a clear picture of what they are actually purchasing.

Understanding the term “Chronic Illness”

Let's start with the confusion between the term "chronic illness" and products called "chronic illness riders". The term "chronic illness" refers to a state of health. Keep in mind that products considered **long-term care** cover all chronic illness, but Chronic Illness Riders do not necessarily cover all "long-term care" claims. There are two things that must be clearly understood before defining the differences in these products:

1. First, it's important to understand that certification of a "chronic illness" is required to trigger any type policy whether a LTCi policy, a LTC rider on life insurance (or an annuity) or a chronic illness rider on life insurance. The tax code definition of chronic illness is not defined by whether the insured will recover or not. IRS §7702(c)(2) defines a "chronically ill individual" as any individual who has been certified by a U.S licensed health care practitioner as:
 - (i) Being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to loss of functional capacity; or
 - (ii) Requiring substantial supervision from threats to health and safety due to severe cognitive impairment.
2. Second, all riders - whether a long-term care rider or a chronic illness rider – allow the death benefit to be accelerated to pay tax free benefits for qualifying conditions pertaining to chronic illness triggers.

What defines whether a rider is a Chronic Illness Rider or a Long-term Care Rider is determined by other factors.

What is the Difference between a Long-Term Care Rider and an Accelerated Death Benefit for Chronic Illness Rider?

Long-term Care Riders

Long-term care riders offer more comprehensive coverage and must be compliant with NAIC long-term care regulations. There are a couple of ways a rider can be classified as true long-term care coverage.

- Long-term Care Riders classified under IRS §7702B - A Long-term Care Rider receiving favorable tax treatment under this code is intended to be a tax-qualified long-term care insurance contract. This is the most common way long-term care riders are filed. All riders mentioned in this paper pay tax-free benefits per IRS code on policies owned by individuals. However, with this particular filing, the policy benefits are also considered accident and health benefits, thus may allow LTC benefits to be paid tax free in situations where a business owns the policy.
- Long-term Care Riders – classified as IRS §101(g) with LTC Model Regulations or similar state regulations – This model is rarely used as a filing for an entire product, though a few companies have done so - primarily on whole life policies. Most often this filing is used to comply with a particular state's requirements to get a rider approved and put in place. Favorable tax treatment of LTC rider benefits come from IRS §101(g), thus this type of rider does not qualify as an accident and health plan. While benefits paid on an individually owned policy are tax free, any LTC benefits paid to business owned policies will not be entirely tax free. However, because it is compliant with LTC Model Regulations, or similar regulations under the filed state, it is considered a long-term care product and maybe referred to as a LTC rider.

Riders with either of the above qualifications may refer to the rider as a LTC product, both verbally and in writing. To qualify for claim, the client needs to meet the basic definition of chronic illness, which as previously stated, requires a U.S. licensed health care practitioner to certify the insured is unable to perform at least two Activities of Daily Living (ADLs) for a period of at least 90 days - or - suffers from severe cognitive impairment. This definition allows for temporary LTC claims in situations where the insured, at some point in time, will fully recover. Thus with this type of policy, conditions such as mild strokes, orthopedic repairs, side effects of certain cancers, etc. can qualify for a long-term care claim (as long as the triggering condition is expected to last 90 days or more).

LTC Riders are underwritten separately from the base policy and an additional fee is charged for the rider, which will add to the policy premium cost. However, LTC monthly benefits and cumulative total benefits are determined at issue (assuming no withdrawals or loans from the policy) so the policy owner knows from day one what their benefits will be should there be a LTC claim.

LTC monthly benefits are paid tax free (within IRS limits) and are paid via the Dollar for Dollar Method, which means each dollar of LTC benefit paid reduces the death benefit by one dollar – resulting in every dollar being paid - either as LTC benefits and/or death benefit. The following chart illustrates how payments of these riders affect the overall payout of the life insurance policy.

This chart assumes LTC benefits are 2% per month of specified amount. The potential for a residual death benefit amount in excess of the initial specified amount is not included since not all companies offer this feature and amounts vary.

Claim Year	Death Benefit/LTC Start of Yr.	LTC Monthly Benefit	Annual LTC Payout	Remaining Death Benefit	Cumulative LTC benefits paid	Total LTC/DB paid if death at end of year
1	\$400,000	\$8,000	\$96,000	\$304,000	\$96,000	\$400,000
2	\$304,000	\$8,000	\$96,000	\$208,000	\$192,000	\$400,000
3	\$208,000	\$8,000	\$96,000	\$112,000	\$288,000	\$400,000
4	\$112,000	\$8,000	\$96,000	\$16,000	\$384,000	\$400,000
5	\$16,000	\$8,000	\$16,000	\$0	\$400,000	\$400,000

Indemnity vs. Reimbursement – How LTC Benefits are Paid

The main differentiator among LTC riders is whether the benefits are paid by an Indemnity or a Reimbursement model.

Reimbursement benefits – Regardless of what the stated maximum monthly benefit is, reimbursement benefits will never pay more than the qualifying LTC expenses incurred. Qualifying expenses in reimbursement policies may exclude or limit reimbursement for the costs of home modifications, medical equipment, or other potential expenses that go along with LTC needs, so it important to read the policy contract carefully so it's clearly understood what will be covered by the policy.

Bills and receipts must be accounted for every month. Some carriers will allow the policy owner the choice of having the service or facility bill the insurance carrier directly, who will then make direct payment back to the facility. Other carriers may require (or allow) the policy holder to submit the bills each month, and then wait for reimbursement of expenses. Either way, it's possible that a service billed for may not be covered by the policy. In that event, the policy owner will have to pay for the ineligible services out of pocket. However, some people may like this type of benefit model 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 benefits - This type of benefit model will pay the maximum monthly LTC benefit the policy allows, regardless of what the LTC expenses are. While some policies may require a licensed service to be involved in the care, with most policies, no bills or receipts need to be submitted to receive monthly benefits. However, keep in mind a few companies offering indemnity payouts call for monthly “proof of billable services” by requiring copies of at least one bill for service (or a signed affidavit of such) be submitted each month to prove continued use of LTC services in order to receive LTC benefits each month (the full benefit amount is still paid).

Cash Indemnity policies have no requirement to use licensed caregivers, place no restrictions on how policy benefits are used, and allow for 100% of LTC benefits to be used for informal and family care. While the entire monthly LTC benefit is always available on any type indemnity benefit plan, some people may choose 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 for medical bills not covered by other sources
- upgrade the home with safety and accessibility features to remain safely in their home longer
- hire help to 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 policy owner, an indemnity LTC rider can also be used in other planning opportunities such as: 1) adding the LTC rider to policy used in an ILIT (irrevocable life insurance trust); 2) adding the LTC rider to a Buy/Sell Agreement or Key Person policy to help supplement the business needs in non-death situations.

Chronic Illness Riders

Riders in this category receive favorable tax treatment under IRS §101(g) 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 are usually built on NAIC Accelerated Death Benefit (ADB) Model Regulations, though states may differ on their interpretation of these regulations.

The majority of companies currently offering these riders contractually require the insured is not only required to be chronically ill per the tax code definition, but that the condition certified *must be expected to likely continue for the rest of the insured's life*; or in other words, with most companies offering this rider, the condition must be non-recoverable (refer to the company and specific state contracts for further details and clarifications). 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. Important to note however, is that the Interstate Compact revised requirements in August of 2014 for chronic illness riders, and now allow these riders to be filed with the ability to pay temporary claims. These regulation changes apply to newly filed products and do not change how current products pay claims. For this reason, particular care should be taken to thoroughly review the contract language so there is a thorough understanding of any limitations in coverage that should be disclosed to clients. These riders all use the acceleration method of paying chronic illness benefits (which resembles an indemnity model) since claims reimbursement is not possible due to not being a long-term care product.

Clarifying Confusion on the Various Methods Used to Charge for Chronic Illness Rider

One common misconception is the belief that some Chronic Illness Riders are “free” – but that’s not the case. The main differentiator among Chronic Illness Riders is *how and when* the rider is charged for; whether the rider is paid for by an additional charge added to the policy premium (which would increase the premium requirement of the base policy) or, by including the rider as a policy feature, then charging for the rider at claim time by calculating a forfeiture of rider benefits and/or death benefits rider.

Additional charge to cost of insurance - A few insurance companies offering Chronic Illness products assign a cost of insurance to the rider and take monthly deductions from policy values. 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. Benefits reduce the death benefit dollar for dollar. Clients wanting clarity in what they purchase may find the additional charge minimal in comparison the potential forfeit of benefits created by the discounting or lien with interest methods.

Discounted Acceleration - Many companies offer 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. Benefits not paid due to the discounting are permanently forfeited as a back end charge for the rider. Because of this, these chronic illness benefits can not be determined until the time comes to go on claim.

The design of this type rider offers minimal risk to the insurance company. Most of these riders do not require underwriting at the time of issue, though in a few instances, a company may require minimal underwriting, but then use a smaller discount formula. The discounting of the benefit is based on several variables including age, gender of the insured, policy rate class, as well as discount 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. Women, with all other factors equal, will have a larger discount factor than men, and thus receive less in total benefits. Additionally, while some companies will accelerate the chronic illness benefits on a monthly basis, many require the discounted acceleration to be paid annually or semi-annually, which could also further reduce the overall amount received.

It is important to explain to clients choosing this type rider that neither the Chronic Illness benefit amount nor the total benefit pool available can be determined at policy issue, 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 it was at policy issue.

The chart below illustrates several possible results if this type of rider is invoked. As you can see; based on the life expectancies, discount interest rates and the assumptions listed below, it could be expected that a 70 year old male invoking a chronic illness claim would be subject to a discount and forfeiture of death benefit of around 34% and a 70 year old female subject to a forfeiture of around 43% of death benefit. An 85 year old male would see a discount on the death benefit of around 15% and an 85 year old female almost 21%.

The following chart provides an example of the effects of discounting:

Age	Death Benefit	Chronic Illness Benefit Amount Elected for Male	Death Benefit Amount Forfeited for Male	Chronic Illness Benefit Amount Elected for Female	Death Benefit Amount Forfeited for Female
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

Assumptions are a \$500,000 policy with \$50,000 of cash value, 7% interest rate at election. Election is 20% of the death benefit of \$100,000 (maximum election 24%)

Lien with Interest Method of Acceleration

Using the lien with interest method, there is generally no underwriting and the rider is offered to most insureds (it may be limited to insureds rated standard or better on the base policy). With a “check of the box” the rider is included as part of the policy, but again, “no charge” does not equate to free.

Generally, with the lien with interest method, a lump sum benefit is paid and the amount is based on a formula such as - *the lesser of: 50% of the death benefit, or \$250,000.* (Other benefit schedules may be available up to 10 years, see contract for details). The insurance company charges interest on the benefit that was accelerated, and that interest rate is determined at time of claim. The interest is essentially the back end “charge” to receive the chronic illness benefit. Generally, the interest accrues daily and is secured by a lien against the policy’s remaining death benefit. The accruing interest continues to reduce the balance of the remaining death benefit, so it’s possible for any remaining death benefit to be totally eliminated and the policy to terminate if the insured lives long enough after accelerating the lump sum benefit. This can make planning for specific death benefit needs difficult.

In addition, the lump sum benefit will be subject to the same Internal Revenue Code formula limitations for tax free benefits that apply to long-term care benefits, thus any excess amount paid above HIPAA or actual cost of care in the year the lump sum is paid would be subject to ordinary income tax.

The chart below provides an example provided by a carrier using such a method.

<ul style="list-style-type: none"> • No underwriting – available to most (may be limited to certain rate classes) • “No charge” (does not equate to free) • Lump sum benefit <ul style="list-style-type: none"> ○ Lesser for 50% of DB or \$250,000 ○ Subject to tax on excess of IRS formula limitations (2016 annual HIPAA limitation of \$124,440) • Interest charged on acceleration <ul style="list-style-type: none"> ○ Backed by lien on remaining DB <p>.....</p> <p style="text-align: center;">Hypothetical Example:</p> <ul style="list-style-type: none"> • Policy Face Amount - \$500,000 • Percentage Elected – 50% • Accelerated Amount - \$250,000 <ul style="list-style-type: none"> ○ Paid as lump sum to policy owner • Interest Rate on Lien – 5.50% 	Years After Election	Lien Accrual	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)	

As you can see, if the insured died shortly after onset of the condition, loss of death benefit would be less than with the chronic illness rider paying by the discount method shown in the previous chart; but if the condition is accompanied by a death that is delayed considerably, it’s possible to lose the entire remaining death benefit to lien interest. Whereas, with a LTC Rider paying benefits through the Dollar for Dollar method, the entire death benefit pool is paid, whether as LTC benefits and/or LTC benefits.

The following charts are intended to help summarize the material in this article. The first chart provides a full break down of features and benefits provided by LTC Riders and Chronic Illness Riders. The second chart is intended to quickly summarize how each type rider would work in conjunction with a claim for benefits and the resulting death benefit.

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

Long-term Care Rider/product		Accelerated Death Benefit for Chronic Illness Rider	
IRS Section 7702B (or LTC Model Regulations)		IRS Section 101(g)	
May be marketed verbally and in writing as long-term care coverage		May NOT be marketed in any manner as long-term care coverage – must be referenced as a “chronic illness” rider	
Pays temporary and permanent claims		Currently, most companies require the condition be permanent to qualify for claim (certified condition must be likely to last the rest of the insured’s life) – see contract for details	
State specific Long-term Care CE as well as a health license may be required to sell these products. Requirements vary by state.		Currently, no Long-term Care CE is required as these products are not considered long-term care products. However, some states may require a health insurance license.	
Has potential for a residual death in excess of original specified death benefit amount ¹		There is no residual death benefit in excess of original death benefit amount. Some companies limit acceleration so that a portion of DB can be held back and paid upon death of insured.	
May pay LTC benefits through indemnity or reimbursement since these are LTC products. LTC benefits generally paid monthly.		Paid by acceleration, which is “indemnity-like”. Claims reimbursement not possible since not a LTC product. Benefits paid monthly, quarterly, semi-annual, annual or one lump sum	
Has additional cost of insurance charge for rider, which adds to premium. LTC benefit pool and monthly benefits are determined upfront and specified at policy issue ²		Some policies underwrite, charge for the rider and determine benefits at issue. Other companies include the rider with policy and either discount benefits at claim time and/or DB at death.	
Differentiators of LTC Riders		Differentiators of 101(g) Products	
Indemnity (charge and underwrite)		Reimbursement (charge and underwrite)	
Full benefit is paid with no regard to the amount of the insured’s actual LTC expenses. Generally, the insurance company does not place any restrictions on how excess benefits can be used. Dollar for Dollar method used, and the full amount in total benefits paid will be at least the issued amount of insurance ² .		Only the actual costs of qualifying LTC services are reimbursed, capped at the maximum monthly LTC benefit amount. Dollar for Dollar method used and the full amount in total benefits paid will be at least the issued amount of insurance ² .	
o monthly receipts or bills to submit. With Cash Indemnity , the insurance company places no restrictions on benefit use	Proof of billable services required each month to get benefits	May elect to have billing coordinated directly with the service provider	Bills must be submitted each month by policy owner, then reimbursed expenses
		The Chronic Illness benefit pool and monthly benefits are determined upfront and are specified at policy issue ²	
		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. The full amount of total benefits paid will be the issued amount of insurance ² .	
		Usually included with policy. Rider benefits and/or death benefit are discounted based on a formula ³	
		These policies rarely pay in total the issued amount of insurance. <u>Discount Method</u> – 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. <u>Lien Method</u> - final DB is determined at death subtracting lien on DB.	
		<u>Discount Method</u> – C.I. benefit pool and benefit amount can <i>not be determined</i> until time of claim. <u>Lien Method</u> – C.I. benefit known at policy issue, but final death benefit can not be determined until death occurs and lien is subtracted from remaining death benefit.	

¹This feature can vary widely among companies.

²Assumes no withdrawals or loans are taken from the policy. Withdrawals or loans will result in a reduction of LTC or chronic illness benefits. Some companies will also reduce the original monthly benefit amount specified at issue to pay a portion of the loan back each month – while other companies will pay full LTC benefit amount issued until the loan balance is reached. See specific company for details.

³ Most companies in this category do not underwrite the rider, however, there are a few companies that do some underwriting for the rider, then apply a smaller **discount** formula than the examples shown in the article

The following chart summarizes how each type rider and benefit payment style will affect the benefits paid for LTC or chronic illness claims as well as the affect on the total amount paid from the policy.

	Dollar for Dollar LTC Rider	Dollar for Dollar Chronic Illness Rider	Lien with Interest Chronic Illness Rider	Discounted Chronic Illness rider
Pays Permanent Claims	YES	YES	YES	YES
Pays Temporary Claims	YES	No for most ¹	No for most ¹	No for most ¹
LTC or Chronic Illness benefit amount 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
Entire policy amount collected if rider is invoked prior to age 100	YES	YES	NO	NO
Residual Death Benefit Paid	YES for most ²	NO	NO	NO

¹ Please refer to the insurance company's rider contract in the section referring to the payment of claims for specific details

² Please refer to the insurance company's rider contract for details on availability and amount of any residual death benefit offered.

Summary

There are numerous solutions available today for insuring against long-term care and chronic illness expenses. In addition to traditional LTC insurance, riders on life insurance open new possibilities for clients looking to find a solution that meets their budget and their concerns. It's important the insurance professional thoroughly understand and be able to explain how each of these policies and riders work, including the advantages and disadvantages of each policy and rider, so client's will be able to make a informed choice for a solution they feel will help meet their needs and expectations.

Please keep in mind that many of the products mentioned in this article require separate underwriting. A long-term care rider can be table rated, which may increase the premium illustrated in the proposal. Long-term care riders and some chronic illness riders can be declined while still approving the base life insurance policy. None of the products mentioned in this article offer inflation protection, so the policy purchased today may not be enough to pay long-term care expenses in the future.

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