The New Frontier of Long-Term Care
by Josh O’Gara, CLU, ChFC, CFP® as seen in advisor today

Adding riders to enhance the features of a base life insurance policy has been popular since the early days of the industry. An increasingly popular type of rider allows clients access to their death benefit if they are in a nursing home or require long-term care. As the number of carriers offering traditional LTCI plans decreases, LTC riders are becoming a primary way for clients to address their need for coverage. Carriers offering this rider report that up to 40 percent of their newly issued policies have it. Therefore, any agent in the LTC marketplace must understand these riders and how they fit clients’ needs.

A U.S. Department of Health and Human Services study found that at least 70 percent of those over the age of 65 will require some form of LTC. This is an overwhelming statistic for most people and demonstrates the need that most Americans face for LTC coverage. When the high probably if needing care is combined with the cost statistics for average nursing-home care, the numbers become staggering.

According to most estimates, the average nursing home costs about $250 a day and the average stay is about 3 1/2 years. When the costs are added up, on “average,” about 70 percent of people will incur a bill of more than $300,000 (this figure can be significantly higher in metropolitan areas). Even with all the data, many consumers choose not to purchase LTCI policies. Given this situation, a producer must look at every solution - and that’s where the LTC rider can come in.

How it works
The most common structure of these riders is an “accelerated benefit,” which provides a specified percentage of the death benefit each month, which can be accessed to offset the cost of LTC. Assume, for example, that a female needs $375,000 of permanent life insurance. Along with the life insurance protection, a needs analysis reveals that she can benefit from LTC protection of $250 a day in the event of being admitted to a nursing home. To address the need, a 2% LTC rider will be added to the policy so that the client can access up to $7,500/month of the total death benefit for LTC payments.

To qualify for benefits, the rider’s requirements are the same as a normal LTC plan in that the client needs assistance with two out of the six Activities of Daily Living, or she has severe cognitive impairment. After the waiting period, she can begin collecting benefits up to the monthly maximum amount. Any benefits used for LTC will reduce the death benefit on a dollar-for-dollar basis until the death benefit is exhausted. Some riders have an “enhanced” benefit feature that doubles the benefit pool for LTC purposes. Although most riders follow this basic format, there are many nuances from one policy to another. To determine the best course of action, an agent must understand the parameters that set one apart from the other. There are four main points of comparison when deciding between various riders:

Reimbursement vs. Indemnity. As with traditional LTC plans, the benefits from LTC plans can be paid on either a reimbursement basis, under which the client is responsible for sending receipts to the insurance company, or an indemnity basis, under which the insurance company sends a check to the client to do with it what she wishes. This is an important analysis point because the administration of indemnity plans is much easier than that of reimbursement plans. Especially for older clients, the task of gathering all their bills together for submission to the insurance company can be daunting. Also, with indemnity plans, the clients can use the benefit amount for whatever she wishes, and she is not constrained by the insurance company’s definition of a “qualified expense.”
7702B or 101(g): This aspect of LTC riders can often be the most important analysis point for clients, but it can also be confusing. Whether a rider falls under 7702B or 101(g) in the IRS code determines the amount of benefit available to the client on a daily basis. Riders administered under Section 7702B of the IRS code are considered to be qualified benefits for LTC. This is important because falling under 7702B allows more flexibility in the amount of benefit that is available to the client. As long as the benefits paid are considered to be LTC benefits, they are tax-free. Riders under 7702B are also allowed to have inflation options on them so that the benefit amount keeps up with the increasing cost of care.

Riders that fall under Section 101(g), on the other hand, are considered to be accelerated benefits for chronic illness. As a result, the benefit amount paid is limited to the maximum HIPAA daily benefit amount. Any benefits that are paid in excess of that amount would be considered taxable. This can be important because clients who want top-of-the-line care may not be able to cover the full expense with the rider benefit. Also, if the cost of care escalates more quickly than the government increases the HIPAA limits, the rider benefit may not cover the full cost of care.

Waiver of Charges: The third point of comparison is whether the insurance charges are waived during a claim. While most carriers will at least waive the charges for the rider, some carrier will still take insurance charges out of the policy while a client is on claim. This could result in a situation in which the policy could lapse prior to a client taking the benefit for LTC.

Waiting Period: Another vital aspect of LTC riders to be considered is the waiting period that must be satisfied before a claim can be made. Some carriers have no waiting period, and as long as the requirements of care can be met, they will pay the benefit. Some carriers may have a waiting period as long as a year prior to paying a claim. To determine the best solution for the client, an agent must consider whether an LTC rider would provide the primary source of funds or if there is another source the client can access prior to dipping into the death benefits of the life insurance policy.

Making the sale

In a highly competitive market in which products are constantly changing and information is easily available to consumers, advisors must have a proper level of knowledge in order to benefit their clients. An LTC rider can provide an intriguing solution to the complexities surrounding the sale of traditional LTC plans.

The concept can be used to either open the door to a new client or provide a compelling reason to revisit the insurance needs of current clients. The new twist on an old idea should prove to be beneficial as people try to get the most value from their insurance policies in today’s tight monetary environment.

Josh O’Gara, CLU, ChFC, CFP® is a brokerage manager at First American Insurance Underwriters. First American is a Needham, MA-based national life brokerage firm specializing in coaching growth-oriented producers and providing them valuable solutions to their complex cases.

He can be contacted at 800-444-8715 or jogara@faiu.com.