Session 38PD: Accelerated Benefit Riders: Opportunities and Risks

Moderator:

Presenters:
Jeanne Meeker Daharsh FSA, MAAA
Paul Garofoli
Denise Liston
John Leo Timmerberg ASA, MAAA
SESSION 38
ACCELERATED BENEFIT RIDERS: OPPORTUNITIES AND RISKS

Jeanne M. Daharsh, FSA, MAAA
Actuarial Reviewer
Interstate Insurance Product Regulation Commission

Valuation Actuary Symposium
San Antonio, Texas
August 28, 2017
AGENDA

• Insurance Compact Overview
• Accelerated Death Benefit Riders
  • Terminal Illness
  • Chronic Illness
  • Critical Illness
• Benefits of Filing with the Insurance Compact
• Q&A / Feedback
Insurance Compact Overview

• Innovative vehicle formalizing joint and cooperative action among states
• Leveraging regulatory expertise to establish Uniform Standards
• Central clearinghouse for prompt review of asset-based insurance products using the Uniform Standards
Insurance Compact Overview

• Compact filings submitted through the System for Electronic Rate and Form Filing (SERFF)
• File **one** submission under **one** set of standards for **one** review and **one** approval valid in **all** Compact jurisdictions
• Uniform Standards for Individual life, annuity, disability income and long-term care, and group term life and group disability income
Insurance Compact Overview

• Review the Uniform Standards & Operating Procedures on the Record
• Use Applicable Checklists (*including the Best Practice Checklist*)
• Review the TOI Link to see the variety of products that can be filed
• Initiate a Pre-filing Communication with the Insurance Compact Office
• General Instructions in SERFF
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

• Additional Standards for Accelerated Death Benefits (IIPRC-L-08-LB-I-AD-3)

• Scope – advance payment of some or all of the death proceeds payable under a life insurance policy upon the occurrence of a qualifying event

• Cannot be described as long-term care insurance or as providing long-term care benefits (otherwise subject to LTC standards)
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

- Qualifying events:
  - Terminal Illness (must always be included)
  - Medical condition requiring extraordinary medical intervention
  - Condition reasonably expected to require continuous confinement in institution for rest of his or her life
  - Specified medical condition that would drastically limit life span
  - Chronic Illness
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

- Chronic Illness (now two definitions allowed)
  - Permanent inability to perform a specified number of ADLs (no more than 2) or permanent severe cognitive impairment and similar forms of dementia
  - IRC Section 7702B & 101(g) definition
    - Inability to perform ADLs for a period of at least 90 days;
    - For periodic payments, requiring within the preceding 12-month benefit period, a licensed health care practitioner certified insured meets requirements of 7702B; and
    - For cognitive impairment, requiring substantial supervision

- Only required to meet one qualifying event
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

- Allows for present value calculation or lien on death benefit approach
- No restriction on the use of the proceeds
- Must provide option for lump sum
- May include option for periodic payments
- Allows per diem to avoid unfavorable tax consequences
- No waiting period but certain elimination periods allowed
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

- Premium or COI charge not allowed for terminal illness qualifying event but allowed for other qualifying events
- Actuarial certification that the value and premium (including COI charge) of the accelerated death benefit is incidental to the life coverage is required (n/a if terminal illness qualifying event)
- The value of the accelerated death benefits (and premium) in relation to the value of the life benefits (and premium) on aggregated basis does not exceed 10%
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

- Incidental Value/Premium Certification
  - Format in Appendix A of the IIPRC Uniform Standard
  - Applicable to Chronic/Critical Illness qualifying events
  - Assumptions must be reviewed at least annually
  - If no longer incidental, company must discontinue offering
Accelerated Death Benefit for Terminal, Critical, Chronic Illness

• Incidental Value/Premium Certification
  • Parameters that impact the value of the benefit may be taken into consideration
    • i.e. the maximum limit on the amount of the accelerated benefit which will be paid; i.e. 50%
    • Assume payment of 100% of face upon death and 50% of face upon non-death trigger
    • Utilize the payment amount at time of trigger; i.e. PV adjustment
    • Parameters may be variable for new business to ensure currently marketed benefit continues to be incidental
Filing Stats

• 5,800 product approvals since June 2007
• 58% Life, 29% Annuities, 9% LTC, 4% DI
• High volume for Accelerated Death Benefit Riders (TI / CI riders)
• Use SERFF Filing Access to view and access approved product filings (some info may be redacted for trade secret in iLTC filings)
• Average Approval Time is 26 business days
  • Excludes company response time
Benefits of Filing with the Insurance Compact

- Submit one filing to Insurance Compact vs. state-by-state
- Use one set of comprehensive Uniform Standards vs. multiple state variations
- Undergo one form & actuarial review vs. many reviews
- Reduce duplicative paperwork, processes, systems testing and implementation
- Receive Compact approval on behalf of 45 states for Life/Annuity
Q&A

Questions & Answers
Discussion Topics

– Understanding Rider Benefit Triggers
– Risk Management
  – Underwriting
  – Claims
– Questions
OVERVIEW
Rider Benefit Triggers

– Understanding the triggers helps guide risk management strategies

– Acceleration occurs
  – Loss of 2 or more Activities of Daily Living
  – Severe Cognitive Impairment
IMPORTANT DEFINITIONS
IADL’s

– Instrumental Activities of Daily Living
  – Medications
  – Telephone Usage
  – Managing Finances
  – Housework
  – Laundry
  – Transportation
  – Meal Preparation
ADL’s

– Activities of Daily Living
  – Bathing
  – Dressing
  – Toileting
  – Transferring
  – Continence
  – Eating
Chronic versus Permanent

– What is chronic?
  – An illness that lasts 3 months or more
    (MedicineNet.com)

– What is permanent?
  – Everlasting: lasting forever or for a very long time, especially without undergoing significant change
  – Unchanging: never changing or expected to change
Sample Policy Language

– Chronically Ill

– Means that a physician or Licensed Health Care Practitioner has certified within the last 12 months that the insured:

– Is permanently unable to perform without Substantial Assistance from another person or at least two ADL’s for a period of 90 consecutive days and thereafter; or

– Requires Substantial Supervision for protection from threats to health and safety due to permanent and severe cognitive impairment.
Underwriting

- Current ADL and/or IADL limitations
- Conditions that have a high likelihood of ADL dependencies
- Capture all relevant information
- Starting point:
  - Are they insurable for the base life policy
Underwriting

– Supplemental Application
  – Auto-decline conditions
    – Strokes/Transient Ischemic Attacks
    – Parkinson’s
    – Multiple Sclerosis
    – Memory Issues
    – Huntington’s Chorea
    – Some Durable Medical Equipment
Underwriting

– Progressive Disease
  – Emphysema
  – Diabetes with complications
  – Degenerating Musculoskeletal Disorders
    – Limited Range of Motion
  – Head Injuries
Underwriting

– Be concerned about
  – Conditions with long progressive decline
  – Anti-selection based on family history
  – Prior service usage
    – Home Health, ALF, PT/OT
  – Balancing morbidity and mortality risk
  – Past disability, workers comp, SSDI
Underwriting

– Common declination reasons
  – Musculoskeletal
  – Diabetes
  – Cardiovascular
  – Cognitive
  – Comorbidities
Typical Underwriting Tools

- Applications
- Supplemental Questionnaires
- Telephonic & In-home Assessments
  - Includes cognitive screening
- Pharmacy Checks
- MIB
- Medical Records
Cognitive Screening

A necessary requirement.....
Cognitive Impairment Progression

**Normal Aging**
- All functions are within normal limits
- This Stage lasts “indefinitely”

**Mild Cognitive Impairment**
- Complaint of memory problems
- No impairment with ADLs or IADLs
- General cognitive function is normal but memory function is abnormal for age and education level.
  - This Stage can go on for at least seven years

**Very Mild to Mild Dementia**
- May Lose IADLs
  - This Stage can go on for two years

**Moderate Dementia**
- Lose ADLs
  - This Stage can go on for two years

**Severe Dementia**
- Lose Speech, gait, posture
  - This Stage can go on for seven years

**Legend**
- Nml Aging
- Mild Cog Imp
- Very Mild Dementia
- Mild Dementia
- Moderate Dementia
- Severe Dementia
CLAIMS
Claims

– Investigation must assure ADL loss
  – Permanent versus recoverable

– Adjudication is similar to traditional LTC
  – Standard measurement tools
  – Provider licensure
  – Plans of care requirements

– Payments
  – Monthly, Quarterly, Annual
  – Reimbursement versus indemnity models
# Top Claim Diagnoses

<table>
<thead>
<tr>
<th>Home Care</th>
<th>Facility Care</th>
</tr>
</thead>
<tbody>
<tr>
<td>– Alzheimer’s</td>
<td>– Alzheimer’s</td>
</tr>
<tr>
<td>– Neurological</td>
<td>– Joint and Disc Disease</td>
</tr>
<tr>
<td>– Joint and Disc Disease</td>
<td>– Neurological</td>
</tr>
<tr>
<td>– Cerebrovascular</td>
<td>– Cerebrovascular</td>
</tr>
<tr>
<td>– Cardiovascular</td>
<td>– Cardiovascular</td>
</tr>
</tbody>
</table>
Claims

– Risk Mitigation

– Recertification of loss
  – Claims need ongoing attention

– Certification by a “LHCP”
  – Physician definition of chronic is very different than how the policy is administered
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ACCELERATED BENEFIT RIDERS: OPPORTUNITIES AND RISKS

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INTRODUCTION

John L. Timmerberg, ASA, MAAA
Accelerated Actuarial
Building an Accelerated Benefit Rider - Many Possible Combinations

I. Whole Life
II. Universal Life
III. Term

- Terminal Illness
- Chronic Illness or LTC
- Critical Illness
- (Pick two or three)

- Dollar for Dollar
- Fractional Value
- Lien

i. Annual Maximum
ii. Lifetime Maximum
iii. Waiver of Premium options
iv. Supplemental Underwriting
Rapid Sales Growth
- LIMRA survey

- Combination Product (life insurance with chronic illness or LTC riders) Sales Experience Double-Digit Growth in 2015

- “New premium totaled $3.1 billion in 2015, which represents 15 percent of all new premium collected for individual life insurance products.”

- 200,000 policies sold; 37% increase over 2014.

- More companies offering acceleration riders with zero premium and often automatically attached to the life product.
Rider Types - Chronic Illness, Critical Illness, Terminal Illness

- **Terminal Illness**
  - physician certifies that the policyholder has life expectancy of 24 months or less;

- **Chronic Illness**
  - unable to perform at least two out of six Activities of Daily Living (bathing, dressing, continence, toileting, transferring, eating); or
  - severely cognitively impaired; and
  - condition certified that it is expected to persist for at least 90 days by licensed health care practitioner

- **Critical Illness**
  - physician certifies that the policyholder has life threatening disease; list typically includes invasive cancer, heart attack, stroke, end stage renal failure or major organ transplant; companies may expand list to include other less common conditions
Three Rider Structures - 
*Dollar-for-Dollar, Fractional Value and Lien*

- **Dollar-for-Dollar Rider Structure**
  - Optional rider for additional premium; supplemental underwriting; benefit payment equal to amount of life policy death benefit reduction. Policy premium is reduced after accelerated benefit payment.

- **Fractional Value Rider Structure**
  - Embedded rider; no additional premium; benefit payment is a fraction of the amount of life policy death benefit reduction. Policy premium is reduced after accelerated benefit payment. (Sometimes called “Discounted Benefit”.)

- **Lien Rider Structure**
  - Embedded rider; no additional premium; benefit payment is like a policy loan and accumulates interest. Premium is **not** reduced after accelerated benefit payment.
Chronic Illness Rider Characteristics

• Agents licensed to sell Life Insurance can sell Chronic Illness riders
  • No need for special LTCI certification or continuing education

• Chronic Illness benefits may be paid in an annual lump sum, or monthly
  • Annual limit on tax free benefits; $124,100 for 2016 (IRS)
    • Increasing each year by medical cost inflation component
  • No restrictions on how policyholder uses the benefit payment
Key Assumption: Life Expectancy of policyholders who accelerate their death benefits

- Key Assumption that supports the existence of all three rider types
  - Chronically ill, critically ill and terminally ill policyholders have much higher mortality as compared to other active policyholders
  - At time of acceleration, life expectancy is relatively short
    - Compare Terminal, Chronic and Critical Illness life expectancies
    - Substantial variations by condition
Example – Chronic Illness, Dollar-for-Dollar

❖ 54 year old male purchases an UL policy with an optional Chronic Illness Accelerated Benefit rider (with additional rider premium); The death benefit is $300,000

❖ 25 years later, he is 79 and he’s had Alzheimer’s for two years
  ❖ His wife, age 73 has been caring for him at home

❖ They decide to take an advance payment of his death benefit, in the amount of $50,000.
  ❖ It’s tax free. No restrictions on how money is used.

❖ They receive the accelerated benefit payment and the policy’s death benefit decreases from $300,000 to $250,000.
  ❖ Going forward, premium is billed on the reduced death benefit amount of $250,000

❖ The policyholder dies five years later and beneficiaries receive $250,000
Example – Critical Illness, Fractional Value

- 49 year old female purchases a 30 year Term policy with an embedded Critical Illness Accelerated Benefit rider (zero additional rider premium); The death benefit is $300,000

- 10 years later, she is 59 and she’s had a heart attack.

- She decides to request an advance payment of her death benefit. For a reduction in her death benefit of $50,000 she receives an accelerated benefit payment of $20,000 (“Fractional Value” of 40%). The money is used for medical expenses.

- The policy’s death benefit decreases from $300,000 to $250,000 and going forward, premium is billed on the reduced death benefit amount of $250,000

- The policyholder dies five years later and beneficiaries receive $250,000.
Comparison of Rider Structures
- $300,000 death benefit; accelerate $50,000 of death benefit

<table>
<thead>
<tr>
<th>Rider Type</th>
<th>Rider Premium?</th>
<th>Policy Premium after Acceleration based on …</th>
<th>Accelerated Death Benefit Payment</th>
<th>Death Benefit paid 5 years later</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollar for Dollar</td>
<td>Yes</td>
<td>$250,000</td>
<td>$50,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Fractional Benefit</td>
<td>No</td>
<td>$250,000</td>
<td>$20,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Lien</td>
<td>No</td>
<td>$300,000</td>
<td>$50,000</td>
<td>$236,186</td>
</tr>
</tbody>
</table>
## Policyholder Behavior Risks

<table>
<thead>
<tr>
<th>Rider Type</th>
<th>Policyholder Behavior Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dollar for Dollar</strong></td>
<td>For policyholder, minimal downside to accelerating as soon as possible. Anti-selection at issue.</td>
</tr>
<tr>
<td><strong>Fractional Benefit</strong></td>
<td>For policyholder, ability to assess Fraction offered, to compare against personal life expectancy. Anti-selection at time of acceleration.</td>
</tr>
<tr>
<td><strong>Lien</strong></td>
<td>For policyholder, motivated to accelerate then lapse, depending upon amount available to accelerate and personal life expectancy.</td>
</tr>
</tbody>
</table>
Pricing
- Rider Costs

• Early Payment of Portion of Death Benefit – “time value of money”
  • net cost: make a payment today as an advance of the death benefit
  • make a smaller benefit payment at time of death

• “Foregone premiums”
  • death benefit is decreased at time of acceleration payment
  • premiums are decreased in proportion
  • company does not collect premiums from time of acceleration until time of death)
  • Cost of “foregone premiums” higher than “time value of money”
Special Considerations by Life Product
- Term Products

- Policyholder value of fractional value accelerated benefit offers
  - Fractional Value Calculations at time of Acceleration
  - Policyholder perspective: Opaque / unpredictable?
  - Impact of policy duration/term on fractional value
  - Communication with applicant at time of sale

- Applying company discretion to determine life expectancy at time of acceleration?
  - Or relying on filed and approved tables

- Post Level Term (PLT) period (policy durations after the initial term period ends)
  - PLT Premium
  - Initial gap and slope; policyholder incentive to lapse
  - How to handle in present value of future premium calculation?
Special Considerations by Life Product
- Permanent Products

- For Permanent products, Account Balance or Net Amount at Risk (NAR)
  - Impact of declining NAR on rider rates and risk

- Predictability of NAR pattern
  - Premium paying patterns or investment returns

- Whole Life – premium payments and account balances are scheduled

- Universal Life – amount of premium payment at policyholder option
  - Policyholder behavior may impact rider rates
Thank You