Accelerated Death Benefits: Filing Challenges in CA, NY and Beyond

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Accelerated Death Benefits Effects on Policy Death Benefit

Regardless of the product type, type of benefit or state of issue, all contracts must spell out what happens to the policy's benefit when an acceleration occurs. The amount payable when death occurs is of course reduced.

But, what policy provisions are needed to correctly accomplish this reduction?

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Flexible Premium Adjustable Life Insurance (aka Universal Life or UL)

Consider a Universal Life (UL) insurance policy where the Death Benefit is defined as the greater of the specified amount and an Internal Revenue Code (IRC) factor times the cash value. The IRC factor could be from either the guideline premium test or the cash value accumulation test.

The policy bases the amount that may be accelerated on the Death Benefit. It is tempting to then have a provision indicating that the Death Benefit is reduced by the amount of the acceleration.

However, this can create problems and is not a good approach.

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UL (cont.)

While a provision like this works fine at the time of the acceleration, it is not clear what it means in the future.

A better approach is having a provision that reduces the specified amount (and Cash Value) by ratio of the amount of the acceleration to the death benefit prior to the acceleration. This type of approach then eliminates the need for a provision indicating how the death benefit is affected, since the death benefit is adjusted automatically under the terms of the contract.

Examples are useful..

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UL (cont.) - Example UL1

Specified Amount	$100,000	
Cash Value	$20,000	
IRC Factor	2.50	
Death Benefit	$100,000	(greater of 100,000 and 2.50 * 20,000)
Amount Accelerated	$40,000	
Ratio Amount Accelerated/DB	.40	
New Specified Amount	$60,000	
New Cash Value	$12,000	
New Death Benefit	$60,000	(greater of $60,000 and 2.50 * 12,000)

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UL (cont.) - Example UL2

Specified Amount	$100,000	
Cash Value	$80,000	
IRC Factor	2.50	
Death Benefit	$200,000	(greater of 100,000 and 2.50 * 80,000)
Amount Accelerated	$40,000	
Ratio Amount Accelerated/DB	.20	
New Specified Amount	$80,000	
New Cash Value	$64,000	
New Death Benefit	$160,000	(greater of $80,000 and 2.50 * 64,000)

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UL (cont.)

In the next two examples we will consider Death Benefit Option 2.

The Death Benefit is the greater of the Specified Amount plus the Cash and the IRC factor times the Cash Value.

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UL (cont.) - Example UL3

Specified Amount	$100,000	
Cash Value	$25,000	
IRC Factor	2.50	
Death Benefit	$125,000	(greater of 100,000 + 25,000 and 2.50 * 25,000)
Amount Accelerated	$25,000	
Ratio Amount Accelerated/DB	.20	
New Specified Amount	$80,000	
New Cash Value	$20,000	
New Death Benefit	$100,000	(greater of 80,000 + 20,000 and 2.50 * 20,000)

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UL (cont.) - Example UL4

Specified Amount	$100,000	
Cash Value	$80,000	
IRC Factor	2.50	
Death Benefit	$200,000	(greater of 100,000 + 80,000 and 2.50 * 80,000)
Amount Accelerated	$25,000	
Ratio Amount Accelerated/DB	.125	
New Specified Amount	$80,000	
New Cash Value	$70,000	
New Death Benefit	$175,000	(greater of 80,000 + 70,000 and 2.50 * 70,000)

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UL (cont.) - Conclusion

First it's important to recognize that, while we did not specifically reduce the death benefit, in each example the Death Benefit did reduce by exactly the amount of the acceleration.

Since the Death Benefit is defined in terms of the Specified Amount and the Cash Value (times the IRC factor), making the appropriate reductions to these automatically produces the correct reduction in the death benefit.

Note – other arrangements may be acceptable.

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Traditional Participating Whole Life Insurance (WL)

Now let's look at a traditional whole life product where the dividends have been used to purchase paid-up additions. The paid-up additions are available for acceleration.

This has a quite different area of concern.

Consider a $100,000 policy was issued to a 20 year old male non-smoker. He is paying an annual premium of $500. At the end of the 20th year the base policy has a cash value of $12,000. There are paid-up additions of $20,000 with a cash value of $5,000.

At this time the total Death Benefit Available for acceleration is $120,000.

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WL (cont.)

The insured has been diagnosed as being terminally ill and has requested an acceleration of $60,000. The forms MUST address which portion of the acceleration comes from the base policy and which portion comes from the paid-up additions. We will consider three different approaches.

Approach 1	The acceleration comes from the base policy first and the paid-up additions are only accelerated if the amount requested exceeds the base policy
Approach 2	The acceleration is done on a proportional basis
Approach 3	The acceleration comes from the paid-up additions first and the base policy is only accelerated if the amount requested exceeds the paid-up additions.

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WL (cont.)

The following table shows the results of the acceleration on the policy for the 3 approaches

		After Acceleration		
	Before Acceleration	Approach 1 Base Policy 1st	Approach 2 Proportional	Approach 3 Paid-Up Add'ns 1st
Base Death Benefit	100,000	40,000	50,000	60,000
Base Cash Value	12,000	4,800	6,000	7200
Required Premium	500	200	250	300
Paid-Up Add'ns Death Benefit	20,000	20,000	10,000	0
Paid-Up Add'ns Cash Value	5,000	5000	2,500	0
Total Death Benefit	120,000	60,000	60,000	60,000
Total Cash Value	17,000	9,800	8,500	7,200
Required Premium	500	200	250	300

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WL (cont.)

I suspect that the proportional approach is the most common one. Approach 3 where the paid-up additions are accelerated first is likely to receive negative comments from regulators.

The forms must clearly address this issue of how each piece of the coverage is accelerated.

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Flexible Premium Adjustable Life Insurance (aka Universal Life or UL) Part 2

The issue just discussed with traditional whole life occurred because there are multiple layers of coverage with different characteristics (i.e. required premium & ratio of cash value to death benefit).

This sort of issue can also arise for some universal life insurance products. While not applicable to all UL products, some products allow for the Death Benefit to be made up of layers with different cost of insurance charges.

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UL Part 2 (cont.)

These layers can occur in a number of ways:

1. A term rider is included with cost of insurance charges different from the base policy; or

2. A Non-Smoker requests an increase in insurance and has subsequently become a Smoker.

Again, the forms must clearly address this issue of how each piece of the coverage is accelerated

In general, I think I would be guided by how requests for decreases in coverage are handled.

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State Requirements

- Qualifying Triggers & Tax Qualification
- Second Opinions
- Interest Rate on Discount/Lien
- General Provisions
- What do you call them?
- Actuarial Requirements
- Other Documents to File

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Qualifying Triggers: Terminal Illness

IIPRC:

A medical condition that is reasonably expected to result in a drastically limited life span for the insured. The company's definition of a drastically limited life span shall have a minimum of "6 months or less" and a maximum of "24 months or less", and shall be specified in the form.

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Qualifying Triggers: Terminal Illness

FLORIDA:

'Terminally ill' means that the patient has a medical prognosis that his or her life expectancy is 1 year or less if the illness runs its normal course.

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Qualifying Triggers: Terminal Illness

NEW YORK:

Upon the diagnosis of terminal illness where life expectancy does not exceed 12 months, or a shorter period (for example six months) if specified in the contract ("A Trigger")

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Qualifying Triggers: Terminal Illness

CALIFORNIA:

- non-correctable medical condition that with reasonable medical certainty will result in death in 12 months or less
- NOT applicable to Article 2.1

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Qualifying Triggers: Terminal Illness

CONNECTICUT:

A medically determinable condition suffered by the insured that can be expected to result in death in a relatively short period of time, such as twelve months and may include, but is not limited to, coronary artery disease, myrocardial infarction, stroke, kidney failure or liver disease.

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Qualifying Triggers: Critical Illness

IIPRC: A medical condition that requires extraordinary medical intervention, such as major organ transplant or continuous artificial life support, without which the insured would die.

OR

A specified medical condition that, in the absence of extensive or extraordinary medical treatment, would result in a drastically limited life span.

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Qualifying Triggers: Critical Illness

CALIFORNIA: The insured has a medical condition that would, in the absence of treatment, result in death within a limited period of time not less than six months.

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Qualifying Triggers: Critical Illness

CONNECTICUT: A medical condition that would, in the absence of extensive or extraordinary medical treatment, result in death in a relatively short period of time, such as 12 months.

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Qualifying Triggers: Critical Illness

NEW YORK: Upon the diagnosis of a medical condition requiring extraordinary medical care or treatment regardless of life expectancy.

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Qualifying Triggers: Chronic Illness

IIPRC: A condition that is reasonably expected to require continuous confinement in an institution, as defined in the form, and the insured is expected to remain there for the rest of his or her life.

OR

A chronic illness defined as permanent inability to perform, without substantial assistance from another individual, a specified number of activities of daily living (bathing, continence, dressing, eating, toileting and transferring), or permanent severe cognitive impairment and similar forms of dementia. The company's definition of chronic illness shall not require the inability to perform more than two activities of daily living.

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Qualifying Triggers: Chronic Illness

CALIFORNIA: Insured has a chronic illness

Chronic Illness- impairment in performing two out of six activities of daily living due to a loss of functional capacity to perform the activity.

OR

Impairment of cognitive ability, meaning the insured needs substantial supervision due to severe cognitive impairment.

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Qualifying Triggers: Chronic Illness

FLORIDA: If using LTC services trigger, subject to LTC insurance requirements.

Otherwise, cannot require confinement.

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Qualifying Triggers: Chronic Illness

CONNECTICUT: A medically determinable condition suffered by the insured, which has resulted in the insured being considered a chronically ill individual for the purposes of 101(g) of IRC, and which has caused the insured to be confined for at least six months in such insured's place of residence or in an institution that provides necessary care or treatment and for which it has been medically determined that such insured is expected to remain confined in such place of residence of institution until death.

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Qualifying Triggers: Chronic Illness

NEW YORK: Upon certification by a licensed health care practitioner of any condition which requires continuous care for the remainder of the insured's life in an eligible facility or at home when the insured is chronically ill, as defined by §7702B of the Internal Revenue Code ("IRC") and regulations thereunder, provided the accelerated payments qualify under Section 101(g)(3) of the IRC and all other applicable sections of federal law in order to maintain favorable tax treatment.

OR

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Upon certification by a licensed health care practitioner that the insured is chronically ill, as defined by §7702B of the IRC and regulations there under, provided the accelerated payments qualify under Section 101(g)(3) of the IRC and all other applicable sections of federal law in order to maintain favorable tax treatment and the insurer that issues such policy is a qualified long term care insurance carrier under Section 4980C of the IRC.

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Chronic Illness Defined

7702B of IRC- "qualified long term care insurance"
7702(c)(2) defines "chronically ill individual"
Certified by health care practitioner as being unable to perform, without substantial assistance, at least two ADLs for a period of at least 90 days.

OR

Requiring substantial supervision to protect individual from threats to health and safety due to severe cognitive impairment.

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Tax Qualification

- Section 101- "Death benefits excluded from gross income"
- 101(g)(1)(A): any amount received under a life insurance contract on the life of an insured who a terminally ill individual
- 101(g)(1)(B): any amount received under a life insurance contract on the life of an insured who is a chronically ill individual - refers to definition in7702B(c)
- 101(g)(3)- "special rules for chronically ill insureds"

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Qualifying Triggers

- CA 10295.2(c): If certification required that chronic illness is expected to last longer than 90 days, filing must include legal memorandum.
- CA 10295.1(a)(2): Payment cannot be conditioned on the receipt of LTC services.
- CA 10295.1(a)(3): lump sum option must be available.
- NY & IIPRC: Must include terminal illness trigger.

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Second Opinions

NEW YORK, IIPRC:

- Must be at company expense
- If conflicting, eligibility determined by third physician mutually agreed upon

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Second Opinions

CALIFORNIA:

If a health care practitioner makes a determination that an insured does not meet the definition of "chronically ill individual," the insurer shall notify the insured that the insurer shall personally examine the insured. The requirement for a second assessment shall not apply if the initial assessment was performed by a practitioner who personally examined the insured.

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Interest Rate on Discount/Lien

NEW YORK, IIPRC, CALIFORNIA:

- Interest rate cannot exceed greater of:
  - Current yield on 90 day Treasury Bills available at date of application for acceleration; and
  - Current maximum adjustable policy loan interest rate (which is based on Moody's Corporate Bond Yield averages).

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Interest Rate on Discount/Lien

CONNECTICUT:

- Interest rate cannot exceed the maximum loan rate specified on currently issued policies.

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General Provisions

IIPRC

- Incontestability- The form shall be incontestable on the same, or a more favorable basis, as the individual policy.
- Reinstatement- The form shall include a reinstatement provision on the same, or more favorable, terms as contained in the policy.

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General Provisions

CALIFORNIA

- Entire Contract; Changes
- Reinstatement
- Incontestability
- Physical Examinations
- Notice of Claim
- Claim Forms

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General Provisions

CALIFORNIA

- Proof of Loss – benefit shall provide that the insurer may require that the insured provide written proof of occurrence or proof of loss no less than 90 days after the termination of the period for which the insurer is liable, and, in the case of claim for any other occurrence or loss, within 90 days after the date of the occurrence or loss…

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General Provisions

CALIFORNIA:

- Free Look- An applicant for an accelerated death benefit shall have the right to return the accelerated death benefit policy or certificate within 30 days of its delivery and to have premium refunded if the applicant is not satisfied for any reason.

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General Provisions

NEW YORK:

- Incontestability- policy shall provide in the incontestable provision:

(1) that a policy or certificate that has been inforce for at least six months but less than two years may be rescinded or an otherwise valid claim for accelerated benefits may be denied upon a showing of misrepresentation that is both material to the acceptance for coverage and which pertains to the condition for which benefits are sought; and

(2) if increases are permitted, that any increase in the policy or certificate that has been in effect for at least six months but less than two years which was applied for and subject to evidence of insurability may be rescinded or an otherwise valid claim for accelerated benefits on the amount of the increase may be denied upon a showing of misrepresentation that is both material to the acceptance for coverage and which pertains to the condition for which benefits are sought.

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What do you call them?

IIPRC:

The cover page of the policy if the benefit is built into the policy, or the first page of the rider, endorsement, or amendment shall include the following in prominent print:

- (a)The term "accelerated death benefit" shall be included in the brief description or descriptive title of the form.

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What do you call them?

CONNECTICUT:

All accelerated benefits policies shall comply with the following disclosure requirements:

- The face of every accelerated benefits policy shall contain: (A) A description of coverage which uses the terminology "accelerated"…

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What do you call them?

CALIFORNIA:

An accelerated death benefit shall be submitted for the approval of the commissioner in the same manner as required under Section 10292 and shall be submitted with the following information:

- (a)The term “accelerated death benefit” shall be included in the descriptive title of the filing.

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What do you call them?

NEW YORK:

If accelerated payment of the death benefit is provided in the policy or certificate, the benefit must be set forth in a separate provision, appropriately captioned as an accelerated death benefit.

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Actuarial Requirements

CALIFORNIA:
- 10295.4 - Actuarial Memo

NEW YORK:
- 41.7 of Reg 143 – Nonforfeiture Memo

IIPRC
- Section 1B – Actuarial Memo

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Actuarial Requirements

FLORIDA:
- 69O-149.002(7)- actuarial demonstration required
- Written and numerical justification for all additional claims administration fees over $100, set out in billable hours by the quarter hour by charges and a detailed explanation of the charges.

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Other Docs to File

CALIFORNIA:
- Replacement Notice – 10295.9(c)
- Summary of effect of payment – 10295.6(a)

NEW YORK:
- Outline of Coverage (if C or D trigger)
- Certification of Tax Counsel
- Additional requirements if issuing to association with D trigger – See II.E.7 in outline

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