



House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

LIFE INSURANCE: REGULATION OF ACCELERATED BENEFITS

House Bill 4907 as introduced
First Analysis (10-2-03)

Sponsor: Rep. John Stahl
Committee: Insurance

THE APPARENT PROBLEM:

Some life insurance policies offer accelerated benefits; that is, they allow all or a portion of the death benefits to be paid in advance of the death of the insured in cases of life-threatening illnesses or medical conditions and other catastrophic circumstances. They are sometimes called “living benefits”. This allows individuals and families to tap into a large asset early in order to deal with financial emergencies stemming from such things as the need for major life-preserving surgeries (such as organ transplants and cardiac operations) and the need for end-of-life or permanent institutional care. According to industry sources, this product is offered in a variety of designs as to coverage and cost. For example, some require an additional premium at the time of purchase; others require payment when a policyholder elects to actually receive accelerated benefits. Sometimes the provision is contained within a policy, sometimes it is an additional rider. The percentage of benefits available also varies by policy, as does the timing of the payout. The conditions that warrant the acceleration of benefits also vary from product to product. Experts say that this option is not for everyone and should not be seen as a replacement for comprehensive health insurance or long-term care insurance, and they point out that the use of accelerated benefits can have an impact on an individual’s tax situation and eligibility for Medicaid. Michigan’s Insurance Code has contained a provision addressing such policies since 1989. According to state regulators, the National Association of Insurance Commissioners (NAIC) has developed a model act for states to use in modifying their laws in this area to deal with the new options developed by the life insurance industry. Legislation based on this model has been introduced in Michigan.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to revise provisions regulating accelerated benefits from life insurance policies. These are benefits paid prior to death (rather than upon death) in specifically

permitted circumstances, notably in cases of life-threatening or catastrophic medical conditions.

Currently, the code includes within the definition of “life insurance” a policy “which prepays in a lump sum not more than 25 percent of the death benefit based on one or more of the following medical conditions if considered to be life threatening or of a catastrophic nature”. Under the bill, these provisions would be eliminated and replaced with more extensive provisions regarding accelerated benefits. The definition of “life insurance” would simply include “insurance [that] prepays the death benefit”. The result would be the removal of the 25 percent limitation on early death benefit payouts and an expanded set of the “qualifying events” that would make accelerated benefits available.

Accelerated benefits. Under the bill, the term “accelerated benefits” would mean benefits payable under a life insurance contract to a policyowner or certificate holder during the lifetime of the insured, in anticipation of death or upon the occurrence of specified life-threatening or catastrophic conditions as defined by the policy or rider that reduce the death benefit otherwise payable under the life insurance contract and that are payable upon the occurrence of a single “qualifying event” that results in the payment of a benefit amount fixed at the time of acceleration.

Qualifying events. The term “qualifying event” would mean one or more of the following:

- a medical condition that would result in a drastically limited life span, as specified in the contract;
- a medical condition that had required or would require extraordinary medical intervention, including major organ transplant or continuous artificial life support, without which the insured would die;

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- a condition that usually requires continuous confinement in an eligible institution as defined in the contract, if the insured is expected to remain there for the rest of his or her life;

a medical condition that would, in the absence of extensive or extraordinary medical treatment, result in a drastically limited life span, including but not limited to coronary artery disease resulting in an acute infarction or requiring surgery, permanent neurological deficit resulting from cerebral vascular accident; end stage renal failure, acquired immune deficiency syndrome (AIDS), or other medical conditions that the Commissioner of the Office of Financial and Insurance Services (OFIS) had approved for any particular filing;

- other qualifying events that the commissioner approved for a particular filing.

Accelerated benefit riders and policies. The bill would specify that an accelerated benefit rider and a life insurance policy with accelerated benefit provisions would be primarily mortality risks rather than morbidity risks and would be considered life insurance benefits subject to Chapters 40 and 44 of the Insurance Code. (Mortality refers to the frequency of death, while morbidity refers to the frequency of illness, sickness, and diseases contracted. Chapter 40 deals with non-group life insurance policies and annuity contracts, and Chapter 44 deals with group life insurance policies.) An accelerated benefit rider and a life insurance policy with accelerated benefit provisions would have to:

- provide the option to take the benefit as a lump sum and not as an annuity contingent upon the life of the insured;
- have no restrictions on the use of the proceeds;
- not affect the accidental death benefit provision, if any, by the payment of the accelerated benefit (if any death benefit remained after payment of an accelerated payment); and
- include the terminology “accelerated benefit” in the descriptive title and not be described or marketed as long-term care insurance or as providing long-term care benefits.

Except as otherwise provided, the insurer of an accelerated benefit rider or policy with accelerated benefit provisions (referred to throughout the summary as “accelerated benefit rider or policy”) would be required to obtain from an assignee or irrevocable beneficiary a signed acknowledgment of concurrence for payout prior to the payment of the

accelerated benefit. If the insurer making the accelerated benefit was itself the assignee, an acknowledgment would not be required.

Disclosure of tax consequences. An insurer of an accelerated benefit rider or policy would be required to provide a disclosure statement both at the time of application and at the time the accelerated benefit payment request was submitted. On both occasions, the customer would have to be notified that receipt of the accelerated benefits could be taxable and that assistance should be sought from a personal tax advisor. The disclosure statement would have to be prominently displayed on the first page of the policy or rider and any other related documents.

Disclosure upon request for acceleration of benefits. If a policyowner or certificate holder of an accelerated benefit rider or policy requested an acceleration, the insurer would have to send a statement to the policyowner or certificate holder and irrevocable beneficiary showing any effect that the payment of the accelerated benefit would have on the policy’s cash value, accumulation account, death benefit, premium, policy loans, and policy liens. The statement would have to disclose that receipt of accelerated benefit payments could be taxable and could adversely affect the recipient’s eligibility for Medicaid or other government benefits or entitlements. If a previous disclosure statement became invalid as a result of an acceleration of the death benefit, the insurer would have to send a revised disclosure statement to the policyowner and certificate holder and irrevocable beneficiary. If the insurer agreed to accelerate death benefits, the insurer would have to issue an amended schedule page to the policyholder to reflect, or would have to notify the certificate holder under a group policy of, any new, reduced in-force face amount of the contract.

Disclosure to applicant for policy or rider. A written disclosure, including a brief description of the accelerated benefit and definitions of the conditions or occurrences triggering payment of the benefits, would have to be given to the applicant for an accelerated benefit rider or policy. The description would have to include an explanation of any effect of the payment of a benefit on the policy’s cash value, accumulation account, death benefit, premium, policy loans, and policy liens. For agent solicited insurance, the agent would have to provide the disclosure form to the applicant prior to or concurrently with the application. Acknowledgment of the disclosure would have to be signed by the applicant and writing agent. For a solicitation by direct response methods, the insurer would have to provide the disclosure form to the applicant at the time the policy was delivered,

with a notice that a full premium refund would be received if the policy was returned to the company within the free look period. For group insurance policies, the disclosure form would have to be contained as part of the certificate of coverage or any related document furnished by the insurer for the certificate holder.

Generic illustration of effects. If there was a premium or cost of insurance charge, the insurer would have to give the applicant for an accelerated benefit rider or policy a generic illustration numerically demonstrating any effect of the payment of a benefit on the policy's cash value, accumulation account, death benefit, premium, policy loans, and policy liens. Procedures for providing the illustration to an applicant in the case of agent solicited insurance, solicitation by direct response methods, and group insurance policies would be similar to those described above in the case of the written disclosure.

Premium or cost of insurance charge. An insurer of an accelerated benefit rider or policy with financing options other than paying the present value of the face amount (as described below) would have to disclose to the policyowner any premium or cost of insurance charge for the accelerated benefit. The insurer would have to make a reasonable effort to ensure that the certificate holder was aware of any additional premium or cost of insurance charge if the certificate holder was required to pay a charge. Upon request of the commissioner, an insurer would have to furnish an actuarial demonstration disclosing the method of arriving at its cost for the accelerated benefit.

Administrative expense charge. The insurer of an accelerated benefit rider or policy would have to disclose to the policy owner any administrative expense charge. Again, the insurer would have to make a reasonable effort to ensure that the certificate holder was aware of any administrative expense charge if the holder was required to pay the charge.

Effective date of accelerated benefit provision. An accelerated benefit provision would take effect on the effective date of the policy or rider, for accidents, and no more than 30 days after the effective date, for illness.

Waiver of premium. An insurer of an accelerated benefit rider or policy could offer a waiver of premium for the accelerated benefit provision in the absence of a regular waiver of premium provision being in effect. At the time the benefit was claimed, the insurer would be required to explain any

continuing premium requirement to keep the policy in force.

No discrimination with respect to qualifying events. An insurer of an accelerated benefit rider or policy could not unfairly discriminate either among insureds with differing qualifying events covered under the policy or among insureds with similar qualifying events covered under the policy. An insurer could not apply further conditions on the payment of the accelerated benefits other than those conditions specified in the policy or rider.

Premium, payment, and interest. The insurer of an accelerated benefit rider or policy could do any of the following. First, the insurer could require a premium charge or cost of insurance charge for the accelerated benefit if based on sound actuarial principles. For group insurance, the additional cost could also be reflected in the experience rating. Second, the insurer could pay a present value of the face amount. The calculation would have to be based on any applicable actuary discount appropriate to the policy design. The interest rate or interest rate methodology used in the calculation would have to be based on sound actuarial principles and disclosed in the contract or actuarial memorandum. Third, the insurer could accrue an interest charge on the amount of the accelerated benefits. The rate or methodology used in the calculation would have to be based on sound actuarial principles and disclosed in the contract or actuarial memorandum. The maximum interest rate used could be no greater than the greater of the current yield on 90-day treasury bills or the current maximum statutory adjustable policy loan interest rate. The interest rate accrued on the portion of the lien that was equal in amount to the cash value of the contract at the time of the benefit acceleration would have to be no more than the policy loan interest rate stated in the contract.

If an accelerated benefit on an accelerated benefit rider or policy was payable, there could be no more than a pro rata reduction in the cash value based on the percentage of death benefits accelerated to produce the accelerated benefit payment. Alternatively, the payment of accelerated benefits, any administrative expense charges, any future premiums, and any accrued interest could be considered a lien against the death benefit of the policy or rider and the access to the cash value could be restricted to any excess of the cash value over the sum of any other outstanding loans and the lien. Future access to additional policy loans could be limited to any excess of the cash value over the sum of the lien and any other outstanding policy loans. If payment of an accelerated benefit on an accelerated

benefit rider or policy resulted in a pro rata reduction in the cash value, the payment could not be applied toward repaying an amount greater than a pro rata portion of any outstanding policy loans.

Other provisions. For an accelerated benefit rider or policy, a qualified actuary would have to describe the accelerated benefits, the risks, the expected costs, and the calculation of statutory reserves in an actuarial memorandum. The insurer would have to maintain in its files descriptions of the bases and procedures used to calculate benefits payable. These descriptions and the actuarial memorandum would have to be made available for examination by the commissioner upon request.

If benefits were provided through the acceleration of benefits under group or individual life policies or riders to an accelerated benefit rider or policy, policy reserves would have to be determined in accordance with Section 834 of the Insurance Code. All valuation assumptions used in constructing the reserves would have to be determined as appropriate for statutory valuation purposes by a member in good standing of the American Academy of Actuaries. The actuary would have to follow both actuarial standards and certification for good and sufficient reserves. The bill would state that reserves in the aggregate “should be” sufficient to cover policies upon which no claim had yet arisen and policies upon which an accelerated claim had arisen. For policies and certificates that provided actuarially equivalent benefits, additional reserves would not need to be established. Policy liens and policy loans, including accrued interest, would represent assets of the insurer for statutory reporting purposes. For a policy on which the policy lien exceeded the policy’s statutory reserve liability, the excess would have to be held as a nonadmitted asset.

MCL 500.602 and 500.603

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the bill would have no fiscal impact on state or local government. (HFA committee analysis dated 9-30-03)

ARGUMENTS:

For:

The bill would provide updated regulation of accelerated death benefits under life insurance policies and riders based on a model statute developed by the National Association of Insurance Commissioners. The model act is said to acknowledge the expanded options available to

consumers from life insurers. State regulators have said that this will allow life insurance customers greater access to life insurance proceeds before death, at a time when access to these assets could make a major difference in the length and quality of life. The new model, according to regulators, still provides consumer protection “by requiring beneficiary notification, disclosure of the financial implications of purchasing the product, and requiring that premiums be based on sound actuarial principles”. The bill would expand the “qualifying events” that allow a policyholder to make use of accelerated benefits, but these are still events involving major medical conditions, such as those that would result in a drastically limited life span, that require extraordinary medical intervention, or that require continuous confinement in an institution for the rest of the insured person’s life. Furthermore, regulators say that adapting state law to the NAIC model will work toward a goal of uniform regulation of insurance products among the states.

Response:

The bill allows all of the proceeds of a life insurance policy to be accelerated; some critics believe there should be a ceiling on the amount of a death benefit that can be accelerated in order to protect the beneficiaries who the policy was originally purchased to protect. Some people also argue for a mandatory second opinion regarding the existence of life threatening conditions. There have also been suggestions that companies be required to file policy forms for approval with the commissioner of the Office of Financial and Insurance Services.

POSITIONS:

The Office of Financial and Insurance Services (OFIS), within the Department of Consumer and Industry Services, supports the bill. (10-1-03)

Among those indicating support for the bill the House Insurance Committee on 10-1-03 were representatives from the Life Insurance Association of Michigan, the American Council of Life Insurers, Jackson National Life, and MetLife.

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.