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AN INTRODUCTION TO LONG TERM CARE INSURANCE

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Long term care insurance protects against a particular class of financial losses caused by chronic illness or disability. Specifically, it enables policyholders to offset the substantial costs of any home care, nursing care or other services they may need when they no longer can care for themselves.

While the need for long term care is not unique to the elderly, long term care services are most often provided to older persons. Likewise, long term care insurance is most commonly purchased by older persons. Perhaps for those reasons, long term care insurance is heavily regulated by a set of authorities that mandate a variety of policy features, marketing practices and other requirements which are unlike those imposed on other classes of insurance.

Understanding those authorities is essential to any insurer who writes long term care insurance, any agent who markets long term care insurance policies, and any examiner who must determine when long term care insurance benefits are payable. Indeed, because every benefit claim involves a policyholder's request for financial help in a time of great personal need, long term care insurance disputes often are extremely volatile. This article therefore will examine some of the laws that make long term care insurance a unique product that can be difficult to administer – and which will make long term care insurance disputes challenging to litigate.

Regulating the Point of Sale

The consumer protection requirements that are imposed on the point of sale of long term care insurance are designed to ensure that consumers make informed and knowledgeable choices about how to insure against their need for long term care. Given those requirements, one might think that the concept of *caveat emptor* (or "let the buyer beware") applies to the sale of long term care insurance. However, that concept actually has little or no application to the sale of long term care insurance. Instead, the concept of *caveat venditor* (or "let the seller beware") probably is more applicable.

1. Disclosure Requirements: At the time of the initial solicitation, each applicant must be given an outline of coverage. The substance and sequence of the text in the outline of coverage usually is prescribed by statute. In general, though, it must describe the benefits provided by the policy, the basic criteria for benefit eligibility, the nature of any limitations or exclusions, and the total annual premium for the benefit options available to the applicant. Cal. Ins. Code §10233.5(h). To be sure, an outline of coverage should not affect the terms of any policy that ultimately is issued. Nevertheless, a claim examiner should review a copy of the outline of coverage, both to confirm that it was given and to consider what effect it might be having on the policyholder's expectations for coverage.

2. Suitability Standards: Long term care insurance is not appropriate for everyone. Every entity marketing long term care insurance therefore is required to develop and use suitability standards to determine whether a proposed policy would be appropriate for an applicant's needs.

Among other things, those suitability standards must consider the applicant's finances and ability to pay for the proposed coverage, the applicant's needs with respect to long term care, the advantages of long term care insurance in meeting those needs, and a comparison of the proposed policy to any existing insurance. Cal. *Ins. Code* §10234.95.

If the insurer concludes that an applicant does not meet its suitability standards, it may reject the application. Otherwise, it must send the applicant a letter about its suitability determination and receive a signed copy of that letter from the applicant before issuing the policy. Cal. *Ins. Code* §10234.95.

Again, the insurer's efforts to confirm the suitability of a proposed policy should not affect the scope of coverage for which the policy provides. However, it sometimes can provide useful insight into the policyholder's expectations for coverage. Claim examiners therefore should consider collecting and reviewing any related documentation that is available.

3. No Unnecessary Replacements: Long term care insurance policies may not be replaced unnecessarily. To that end, many states make the replacement of a long term care insurance policy contingent upon the insurer's declaration that the replacement policy "materially improves the position of the insured." Cal. *Ins. Code* §10234.97(a).

Importantly, any insurer issuing a replacement policy must waive all time limitations in the new policy – including those applicable to preexisting conditions and waiting periods – to the extent that similar provisions in the original policy already were satisfied. Cal. *Ins. Code* §10233.3. For that reason, claim examiners sometimes may need to review the records concerning any prior policies and/or claims involving the same insured.

Statutorily-Mandated Complexities

A long term care insurance policy generally must take one of three forms. Some cover only care that is provided in an institutional setting ("nursing home only" policies). Some are limited to home care and community-based services ("home care only" policies). Others cover both institutional care and home care ("comprehensive long-term care" policies). The application, outline of coverage and first page of the policy form must prominently identify which form the policy takes. Cal. *Ins. Code* §10232.1.

Other statutes attempt to standardize the benefits provided by different forms of long term care insurance. To promote the use of long term care insurance as a flexible solution to consumers' needs, they also mandate that long term care insurers make certain coverage options available to their policyholders. From the consumer's perspective, though, those same statutes mandate a set of policy features that can be confusing and make policies difficult to understand. In order to effectively manage a policyholder's expectations during the claims process, then, claim examiners should recognize that the availability of benefits often turns on choices the policyholder made at the point of sale.

1. Home Care Policies: Home care policies must provide benefits for home health care, adult day care, personal care, homemaker services, hospice services and respite care. Cal. *Ins. Code* §10232.9(a). They cannot make benefits contingent upon a showing of medical necessity. Cal. *Ins. Code* §10232.9(c)(7). They also cannot limit or exclude benefits by requiring a need for care in a nursing home, requiring that skilled nursing services be used before unskilled services, requiring the existence of an acute condition, or limiting benefits to services provided by Medicare-certified providers. Cal. *Ins. Code* §10232.9(c).

2. Nursing Home Policies: Every long term care insurance policy that provides reimbursement for care in a nursing facility must cover and reimburse *per diem* expenses, as well as the costs of ancillary supplies and services, up to the maximum lifetime daily facility benefit set forth in the policy. Cal. *Ins. Code* §10232.95.

3. Comprehensive Policies: Every comprehensive long term care policy that provides for both institutional care and home care must pay a benefit for home care that is at least 50 percent of the maximum benefit payment for institutional care. Cal. *Ins. Code* §10232.9(d).

4. Optional Assisted Living Care: Regardless of the form of policy, a long term care insurer must offer every applicant an option to purchase a policy that covers assisted living care in a licensed residential care facility. If the applicant purchases such a policy, the minimum benefit must be at least 50 percent of the maximum benefit for institutional care. Cal. *Ins. Code* §10232.92.

5. Optional Inflation Protection: Insurers must offer every applicant an option to purchase a policy with an inflation protection feature. That provision must increase benefit levels by at least 5 percent annually. If those benefit increases are intended to be automatic, the insurer must state in its offer a premium for that benefit which it expects to remain constant. Cal. *Ins. Code* §10237.1. When considering that offer, the applicant must be allowed to review the outline of coverage and a set of graphs which compare the benefits and premiums with and without the inflation protection feature. If the applicant rejects the offer, he or she must do so by signing a document which confirms receipt of those documents and the applicant's decision to reject inflation protection. Cal. *Ins. Code* §10237.5(b).

6. Lifetime Benefit Maximums: Every long term care insurance policy must define the maximum lifetime benefit as a single dollar amount that may be used interchangeably for any home- and community-based services, assisted living benefits, or institutional care covered by the policy. Cal. *Ins. Code* §10232.93.

The Policy as a Living Document

Every individual long term care insurance policy must be either guaranteed renewable or noncancelable. Cal. *Ins. Code* §10236. Accordingly, an insurer must obtain the policyholder's written agreement before changing a policy in a way that increases premiums or changes the benefits for which it provides. Cal. *Ins. Code* §10235.14(b). For that reason, claim examiners sometimes are required to consider claims under policies written decades before the versions currently being issued by their companies.

However, policyholders must be afforded certain rights to change the terms of their coverage. For example, each policy must allow the policyholder to lower their premiums by sacrificing certain benefits. Cal. *Ins. Code* §10235.50(a). Every policyholder also must be given an opportunity to take advantage of any new benefits or criteria for benefit eligibility that the insurer may develop after the policy is issued. Cal. *Ins. Code* §10235.52. While those changes may be incorporated into an entirely new policy, they sometimes are made through riders or endorsements which become part of the original policy. Cal. *Ins. Code* §102325.52(a)(2)(A)-(C). Claim examiners therefore should carefully review the policy documents to confirm that they accurately reflect the policyholder's choices.

Protecting Policyholders from Themselves

Before the policy is issued, the applicant must be given the right to designate at least one other person to receive premium notices, lapse notices and other communications about the policy's termination for non-payment of premiums. If the applicant chooses not to exercise that right, the insurer must obtain a written waiver. Cal. *Ins. Code* §10235.40(a).

No long term care insurance policy can lapse for non-payment of premiums unless the insurer gives proper notice to the policyholder and his or her designee. Cal. *Ins. Code* §10235.40(d). All policies also must provide for reinstatement upon proof that the insured had a cognitive impairment or loss of functional capacity that was sufficient to qualify for benefits under the policy. Cal. *Ins. Code* §10235.40(e). However, the policyholder will lose that right if he or she fails to request reinstatement within five months of the date of lapse. *Id.*

HIPAA imposes one other requirement on long term care insurance policies that are intended to be tax-qualified. Specifically, it requires that such policies include nonforfeiture provisions which provide for at least one of the following forms of benefits in the event of lapse: reduced paid-up insurance; extended term insurance; or a shortened benefit period. 26 U.S.C. §7702B(4)(B). Under California law, insurers must offer each applicant an option to purchase a "nonforfeiture benefit" at the time of application, pursuant to which an insured who has paid 10 years of premiums may be eligible for three months of nursing facility benefits – even after the policy has lapsed. Cal. *Ins. Code* §10235.30.

The Criteria for Benefit Eligibility

Long term care insurance policies generally provide that benefits will be paid only if the insured has either an impairment of cognitive ability or an impairment with respect to certain activities of daily living (or ADL's). The claim examiner's primary charge therefore usually involves evaluating the insured's level of cognitive functioning and independence.

Evidence that the insured needs substantial supervision because of a severe cognitive impairment usually will suffice. Cal. *Ins. Code* §10232.8(d); see also, 26 U.S.C. §7702B(c)(2)(A)(iii). When that evidence is absent, though, the claim examiner must separately assess the insured's need for assistance with a specific set of ADL's.

In that regard, federal law prohibits policies which are intended to qualify for favorable tax treatment from making benefits available unless the insured has an impairment of cognitive ability or with respect to any two of six ADL's: eating, bathing, dressing, transferring, toileting and continence. 28 U.S.C. §7702B(c)(2)(i)-(ii). However, many states allow insurers to issue policies with a broader set of eligibility criteria which do not qualify for favorable tax treatment. For example, California requires that every insurer offering a tax-qualified policy also offer a non-tax qualified policy which makes benefits available when the insured has an impairment of cognitive ability or with respect to any two of *seven* ADL's. Cal. *Ins. Code* §10232.25(a); see also, Cal. *Ins. Code* §10232.8(a) [defining ADL's to include "ambulating"].

Every long term care insurance policy must prominently indicate on its application, the outline of coverage and on the face of the policy form whether it was intended to qualify for favorable treatment under the federal tax laws. Cal. *Ins. Code* §10232.1(a). To confirm which set of daily activities the insured must need help with in order to qualify for benefits, claim examiners should nonetheless carefully review the terms of the policy itself.

Prohibited Exclusions and Limitations

Subject to certain enumerated exceptions, no long term care insurance policy can limit or exclude benefits by type of illness, treatment, medical condition or accident. 26 U.S.C. §7702B(g)(2)(A)(i)(I); Cal. *Ins. Code* §10235.8. In California, the permissible exclusions and limitations based upon type of illness, treatment, medical condition or accident include only the following: (a) preexisting conditions or diseases; (b) mental or nervous disorders; (c) alcoholism and drug addiction; and (d) illness, treatment, or a medical condition arising out of war, participation in a felony, service in the armed service, intentionally self-inflicted injury, or aviation. Cal. *Ins. Code* §10235.8(d).

The scope of those permissible exclusions (as well as those that are not based upon the type of illness, treatment, medical condition or accident) often is limited by other statutes. Among other things, they cannot operate to make benefits dependent upon the policyholder's having had a prior hospitalization. Similarly, they cannot operate to make eligibility for benefits provided in an institutional care setting dependent upon the receipt of a higher level of institutional care, nor can they make the availability of benefits for community-based care, home health care or home care dependent upon a prior institutionalization. Likewise, they cannot make eligibility for non-institutional benefits dependent upon a prior institutional stay of more than 30 days. Cal. *Ins. Code* §10232.5.

Some of the key limitations on other policy exclusions are as follows:

1. Preexisting Conditions: As noted above, long term care insurance policies may exclude coverage for preexisting conditions. However, the policy must define the phrase "preexisting condition" in a way that is no more restrictive than a condition for which medical advice or treatment was recommended by (or received from) a health care provider within six months preceding the effective date of coverage. Cal. *Ins. Code* §10232.4(a). Likewise, the policy cannot exclude coverage for a loss which is the result of a preexisting condition unless the loss begins within six months of the effective date of coverage. Cal. *Ins. Code* §10232.4(b).

2. Mental and Nervous Conditions: Long term care insurance policies may exclude coverage for losses that are attributable to mental or nervous disorders. However, they cannot define the phrase "mental or nervous disorder" to include more than "neurosis, psychoneurosis, psychopathy, psychosis, or mental or emotional disease or disorder." Cal. *Ins. Code* §10235.2(b). Policies also cannot use mental and nervous disorder exclusions to limit or deny benefits for losses attributable to Alzheimer's disease or other "progressive, degenerative, and dementing illnesses." Cal. *Ins. Code* §§10235.8(b) and 10233.2.

3. Medical Necessity: Before paying benefits under a long term care insurance policy, an insurer may require a written declaration that the services for which a claim has been presented are necessary. In that regard, it may obtain a written declaration from a physician, independent needs assessment agency or other source of independent judgment that the insurer deems suitable. Cal. *Ins. Code* §10233.

4. Reasonable and Customary: Long term care insurance policies cannot limit benefits to those charges which are "usual and customary", "reasonable and customary", or otherwise subject to a standard using words of similar import. Cal. *Ins. Code* §10233.2(e).

Rescissions and Post-Claim Underwriting

The questions in an application for long term care insurance must contain "clear, unambiguous, short, simple questions designed to ascertain the health condition of the applicant."

To that end, they cannot be compound. Moreover, unless it calls for the applicant to identify the name of any prescribed medications or prescribing physicians, each question must require only a “yes” or “no” answer. Cal. *Ins. Code* §10232.3(a).

Theoretically, the simplified structure of a long term care insurance application could enable insurers to streamline their underwriting processes. However, no long term care insurance policy may be “field-issued.” Cal. *Ins. Code* §10232.3(d). In fact, long term care insurers are required to complete their medical underwriting and “resolve all reasonable questions arising from information submitted on or with the application before issuing the policy.” Cal. *Ins. Code* §10232.3(c).

Any insurer which fails to discharge that obligation will find its ability to deny benefits or rescind coverage on the basis of a misrepresentation in the application to be greatly complicated. Specifically, an insurer who does not fully underwrite the application before issuing a long term care insurance policy cannot rescind the policy or deny an otherwise valid claim without “clear and convincing evidence” of either fraud or a misrepresentation that: (a) pertains to the condition for which benefits are sought; (b) involves a chronic condition; (c) involves dates of treatment before the date of application; or (d) is material to the acceptance for coverage. Cal. *Ins. Code* §10232.3(c).

Proof of that type is not typically required in other contexts. In California, for example, even an innocent misrepresentation of a material fact gives the insurer a right to rescind other types of insurance policies. See, e.g., *Barrera v. State Farm Mutual Automobile Ins. Co.*, 71 Cal.2d 659, 666 (1969). Likewise, California does not follow the loss-causation rule for other classes of insurance. See, e.g., *Cohen v. Penn Mutual Life Ins. Co.*, 48 Cal.2d 720, 726 (1957). In addition, California’s statutory definition of materiality uses an objective standard and is broad enough to include all facts which might influence the insurer in forming its estimate of the disadvantages of the proposed contract, or in making its inquiries. Cal. *Ins. Code* §334. A long term care insurer which engages in post-claim underwriting therefore must be prepared to make a greater showing – under the more demanding “clear and convincing evidence” standard – when attempting to rescind a policy.

Additional Statutory Duties

The statutes in many states impose certain duties on insurers and agents which are unique to the long term care insurance industry. Thus far, the scope of those duties is largely untested. Similarly, the remedies for which they provide are not yet certain. For a variety of reasons, then, those statutory duties are likely to play a significant part in any litigation involving long term care insurance.

1. Duty of Honesty: With regard to long term care insurance, all insurers, brokers, agents and other persons engaged in the business of insurance owe policyholders a duty of honesty. Cal. *Ins. Code* §10234.8(a). However, the statutes separately provide that the conduct of an insurer, broker, or agent “during the offer of sale of a policy previous to the purchase is relevant to any action alleging a breach of the duty of honesty.” Cal. *Ins. Code* §10234.8(b). The statutory duty of honesty therefore is one owed to both policyholders and applicants. In other words, it is not dependent on the issuance of a policy or the formation of a contract.

2. Duty of Good Faith and Fair Dealing: In California, a covenant of good faith and fair dealing impliedly exists as a part of every contract. See, e.g., *Comunale v. Traders & General Ins. Co.*, 50 Cal.2d 654, 658 (1958). To establish a breach of that implied covenant, an insured generally must show that the insurer withheld a benefit payable under the policy, unreasonably and without proper cause. See, e.g., *California Shoppers, Inc. v. Royal Globe Ins. Co.*, 175 Cal.App.3d 1, 15, 54 (1985). Upon making that proof, an insured typically can recover contract benefits and pursue claims for tort damages.

Because the implied covenant arises out of a contract, the existence of a contractual relationship between the parties is a prerequisite to any bad faith claim. See, e.g., *Smith v. City and County of San Francisco*, 225 Cal.App.3d 38, 49 (1990). For that reason, the implied covenant normally applies only to the post-contract formation conduct of the contracting parties. See, e.g., *Gruenberg v. Aetna Insurance Co.*, 9 Cal.3d 566, 576 (1973). However, the statutes regarding long term care insurance impose a statutory duty of good faith and fair dealing that applies to “insurers, brokers, agents and others engaged in the business of insurance.” Cal. *Ins. Code* §10234.8(a). As with the duty of honesty, the statutes also provide that the conduct of an insurer, broker, or agent “during the offer of sale of a policy previous to the purchase is relevant to any action alleging a breach of the duty of . . . good faith and fair dealing.” Cal. *Ins. Code* §10234.8(b). Unlike the implied covenant, then, the statutory duty of good faith and fair dealing is not dependent on the existence of a contract, is not limited to parties who are in privity, and is broad enough to cover the parties’ pre-contract actions.

Outlook for the Future

Compared to other parts of the insurance industry, long term care insurance is relatively new. In fact, the earliest long term care insurance policies were issued just a few decades ago. The regulatory climate and legal treatment of long term care insurance claims therefore is still developing.

At the same time, the long term care insurance industry is well-positioned for tremendous growth. Indeed, as the population ages, more and more people will experience unexpected needs for long term care and discover that other methods of paying for the costs of that care often are inadequate. In turn, the number of companies issuing long term care insurance is rising quickly – as is their market penetration. Claim examiners therefore should become familiar with this emerging segment of the insurance industry and start preparing to meet some of its unique challenges.

About the Author

Rob Pohls is the Managing Attorney of *Pohls & Associates*, a law firm with offices in both Northern and Southern California that he founded in 1999 to represent life, health, disability and long term care insurance companies in bad faith, ERISA and other complex forms of litigation. He is a former Chair of the Health & Disability Insurance Law Committee of the ABA’s Tort Trial and Insurance Practice Section, an active member of DRI’s Life, Health and Disability Insurance Committee, a longtime member of the Association of Life Insurance Counsel, and a frequent speaker on issues of interest to the life, health, disability and long term care insurance industries. To learn more about Rob, his firm and his practice, visit his firm’s website at www.califehealth.com or send him an e-mail at: rpohls@califehealth.com.