Episode #259: How Do Accelerated Benefit Riders Actually Work?

Video Transcription

Hey there everybody. Thank you so much for watching today's video. My name is Kevin Nuber and what I'm going to be talking about today is how exactly accelerated benefit riders work.

Sometimes they could be a little bit confusing, but the important thing to understand is the actual impact that these riders have on your life should you ever need one.

A very close and personal friend who was very meaningful to me once bought a life insurance policy when he was 65 years old and he purchased his policy for a million dollars. Now, he bought this policy for the normal reasons a person might need life insurance.

This policy happened to have an accelerated death benefit rider on it, but it's not why he purchased it. Fast forward five years, he's now 70 years old, and two things happen. First, he's diagnosed with ALS. The second thing that happens is he's diagnosed with stage four cancer.

Now, fortunately, he was able to beat stage four cancer, but that's not how it works with ALS. And he realized that he only had about three to five more years to live.

Suddenly it dawned on him that he had purchased this life insurance policy that had something called an accelerated benefit rider. ALS and cancer were one of those things that triggered this benefit.

So he applied to the insurance company and they said, "All right, great, you qualify. What we're going to do is we're going to accelerate to you

$750,000 of death benefit, and by doing that, you're going to get a check for $650,000."

So he looked at this offer and he said, "You know what? I have two options. One, it is I can wait till I die and my wife can get this money. Or two, I can take the $650,000 today and I can choose to live the best three to five years of my life while I'm still alive and those memories will be priceless." And that's what he chose to do.

He built the house of his dreams, this huge house near the beach overlooking the water, and he lived the best three to five years of his life possible. And it's a fantastic story to show you the importance of why you should always have one of these riders on your policy.

But the problem is sometimes people get stuck in the weeds about something that I might have glossed over that you might not have caught. You see, the insurance company accelerated to him $750,000 of death benefit, but he only got a check for $650,000. So, you know, why does that happen?

Sometimes when people are determining whether or not they want to buy one of these policies, they get stuck in the weeds over that portion of it and forget the more important part, which is those prices memories that he was able to have while he was still alive.

Today, what I want to talk about is exactly why there's this acceleration and why that check is always going to be something less than the amount of death benefit that gets accelerated to you so that you can feel comfortable about how these riders work and purchase a policy that has one.

So why is the check something less? Well, here's how this works, it's the benefit calculation. Let's say that you have somebody who's 50 years old today, okay? This 50-year-old right now if he or she was in really good health, then the life expectancy of this person is going to be 36 years.

So, the insurance company's expecting them to live till age 86. Let's say this person has a death benefit of a million dollars. The insurance company's not going to be sitting around on a million dollars at his age 50 or her age 50, because the chances of that person passing away are not very high.

They know that it's 36 years away until its mortality event. So something happens to this person. Now this person has cancer or a stroke or blindness or organ failure or ALS or something that triggers one of these benefits that now this person qualifies for it. And they say, "Hey, I wanted to receive this acceleration."

The insurance company does underwriting, orders medical records, and comes to a new determination of this person's life expectancy of age 62. So now the new life expectancy is only 12 years away, not the 36 years away that they were originally expecting.

So the question I have for you is, if the insurance company is going to accelerate $500,000 of death benefit, what is the actual check that the person's going to receive today? Well, here's how this works, and I'm going to say it in a simple way and a little bit more complicated way.

The simple way is to say that the benefit, the actual check is going to be the present value of that future death benefit. That future death benefit member, they're going to expect to pay it in 12 years. So 12 years is the first number that comes into this equation.

The second thing is if the insurance company doesn't give them this money, what is the insurance company going to earn on that money if they keep it?

So let's say it's 5%. Let's say they're earning 5% on the money. So that's the second piece. That's the discount rate, 5%. The third thing is, what are the mortality charges over these next 12 years? So that's the third thing.

So, the more complicated answer is the actual check. The reason why they accelerated $500,000 of death benefit in his check is only for $350,000 is because the insurance company is giving them the present value of the death benefit.

They're taking that $500,000, they're going backward 5% for 12 years, and they're deducting the mortality expenses. This is as simple as that. That is how they determine how much that check is actually going to be.

Now, one of the things that people can be nervous about is that the insurance company can't necessarily tell you today when you're looking to purchase the policy, what the potential benefit amounts are going to be, because they don't know.

They don't know what your mortality is going to be, they don't know what the discount rate's going to be, and they don't know what the mortality charges are going to be. But generally, this is how it's going to work. And these are the factors that determine how much you receive.

But even if you qualify for one of these riders, it doesn't mean that you necessarily want to actually take the benefit while you're still alive. And here's why.

Maybe you do, maybe you don't. Most of the time you do, but there are some things you have to think about and there are some important considerations you have to take into mind.

The first thing you have to do is you have to file for the claim. You have to file for the claim and get the offer. Let them do this calculation, and they'll tell you exactly how much the check is going to be.

For example, if this 50-year-old had a mortality that went from 86 to age 80, it's not going to be very favorable because their life expectancy hasn't changed much. So that's part of the thing that you have to do when you do the claim.

The second thing you have to take into consideration is, what is the current death benefit? Not just what is it, but what is it going to be used for? Does that death benefit need to be there when you pass away because there's some liability that that death benefit going towards?

Or, like the person I mentioned to you, can that death benefit be spent now while you're still alive in order to live your best life? So that's the other thing you need to think about.

The third thing is, is how much cash value you have in your policy. It's a little bit complicated but I'll keep it simple. If you have a very high cash value policy and with the least amount of death benefit possible, and you take an acceleration of the death benefit, a large portion of that death benefit is going to be a return of your own cash value.

This makes it potentially more or less advantageous when you take the acceleration. So that's just another consideration that you have to think about when you file for the claim.

The last thing is this, is that, if you understand this, if I did a good job explaining this to you and you understand how this works, then let's say that the insurance company does the new calculation and all that, they say that the accelerated benefit rider, let's say the discount rate there they're going to use is 5%. Okay?

Let's say that you could take a loan from your policy and they're going to charge you 5%, then mathematically, there's no difference between taking an acceleration of the death benefit versus taking a loan from your policy.

So, you might actually end up taking a loan because there's a little bit more flexibility versus an accelerated benefit rider. Okay? So these are all the things that you should think about. But the important part is don't get lost in the weeds.

I know I spent a lot of time trying to explain the intricacies of how this works. It's not the most important part. This is not the most important part of how one of these riders work. The most important part is the story that I told you at the very beginning.

It's that you have the option of taking the death benefit while you're still alive. What if you have some sort of significant medical event and now you have hundreds of thousands of dollars in medical expenses, you don't have the money and you need the money in order to get the treatment that you want and that you need in order to live, then you're going to take the accelerated death benefit.

That's an option that you have. Imagine the impact that's going to have on you and your family. Or if you have, for example, the story I told you, you have ALS and it's something that you can't beat and you know you have this short window of time to live, then you can choose to live your best few years that you have left to live and have those priceless memories rather than waiting until you actually die for someone to receive that death benefit.

That's the most important part and don't get lost in some of these calculations about how it works. So hopefully, this makes a little bit more sense to you, and I hope that the next policy that you choose to purchase has one of these riders on them.

Thank you very much for watching this video.