

PROHIBITION ON THE USE OF DISCRETIONARY CLAUSES MODEL ACT

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Section 1. Short Title

This Act shall be known and may be cited as the Discretionary Clause Prohibition Act.

Drafting Note: In some states existing statutes may provide the commissioner with sufficient authority to promulgate the provisions of this Act as a regulation or bulletin. States should review existing authority and determine whether to adopt this model as an act or adapt it to promulgate as a regulation or bulletin.

Section 2. Purpose and Intent

The purpose of this Act is to assure that health insurance benefits and disability income protection coverage are contractually guaranteed, and to avoid the conflict of interest that occurs when the carrier responsible for providing benefits has discretionary authority to decide what benefits are due. Nothing in this Act shall be construed as imposing any requirement or duty on any person other than a health carrier or insurer that offers disability income protection coverage.

Section 3. Definitions

- A. “Commissioner” means the Commissioner of Insurance.

Drafting Note: Use the title of the chief insurance regulatory official wherever the term “commissioner” appears. If the jurisdiction of certain health carriers, such as health maintenance organizations, lies with some state agency other than the insurance department, or if there is dual regulation, a state should add language referencing that agency to ensure the appropriate coordination of responsibilities.

- B. “Disability income protection coverage” is a policy, contract, certificate or agreement that provides for periodic payments, weekly or monthly, for a specified period during the continuance of disability resulting from either sickness or injury or a combination of them.
- C. “Health care services” means services for the diagnosis, prevention, treatment, cure or relief of a health condition, illness, injury or disease.
- D. “Health carrier” means an entity subject to the insurance laws and regulations of this state, or subject to the jurisdiction of the commissioner, that contracts or offers to contract to provide, deliver, arrange for, pay for or reimburse any of the costs of health care services, including a sickness and accident insurance company, a health maintenance organization, a nonprofit hospital and health service cooperation, or any other entity providing a plan of health insurance, health benefits or health services.

Drafting Note: States that license health maintenance organizations pursuant to statutes other than the insurance statutes and regulations, such as the public health laws, will want to reference the applicable statute instead of, or in addition to, the insurance laws and regulations.

- E. “Person” means an individual, a corporation, a partnership, an association, a joint venture, a joint stock company, a trust, an unincorporated organization, any similar entity or combination of the foregoing.

Section 4. Discretionary Clauses Prohibited

- A. No policy, contract, certificate or agreement offered or issued in this state by a health carrier to provide, deliver, arrange for, pay for or reimburse any of the costs of health care services may contain a provision purporting to reserve discretion to the health carrier to interpret the terms of the contract, or to provide standards of interpretation or review that are inconsistent with the laws of this state.

- B. No policy, contract, certificate or agreement offered or issued in this state providing for disability income protection coverage may contain a provision purporting to reserve discretion to the insurer to interpret the terms of the contract, or to provide standards of interpretation or review that are inconsistent with the laws of this state.

Section 5. Penalties

A violation of this Act shall [insert appropriate administrative penalty from state law].

Section 6. Separability

If any provision of this Act, or the application of the provision to any person or circumstance, shall be held invalid, the remainder of the Act, and the application of the provision to persons or circumstances other than those to which it is held invalid, shall not be affected.

Section 7. Effective Date

This Act shall be effective [insert date].

Chronological Summary of Action (all references are to the Proceedings of the NAIC)

2001 Proc. 4th Quarter 215-216 (model adopted later is printed here).

2002 Proc. 1st Quarter 12,176, 180-181 (adopted).

2004 Proc. 3rd Quarter 674-675, 677-678 (amended and reprinted, adopted by parent committee).

2004 Proc. 4th Quarter 57 (adopted by Plenary).

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This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state’s activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC’s interpretation may or may not be shared by the individual states or by interested readers.

This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.

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KEY:

MODEL ADOPTION: States that have citations identified in this column adopted the most recent version of the NAIC model in a **substantially similar manner**. This requires states to adopt the model in its entirety but does allow for variations in style and format. States that have adopted portions of the current NAIC model will be included in this column with an explanatory note.

RELATED STATE ACTIVITY: Examples of Related State Activity include but are not limited to: older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. States that have citations identified in this column **only** (and nothing listed in the Model Adoption column) have **not** adopted the most recent version of the NAIC model in a **substantially similar manner**.

NO CURRENT ACTIVITY: No state activity on the topic as of the date of the most recent update. This includes states that have repealed legislation as well as states that have never adopted legislation.

NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Alabama	NO CURRENT ACTIVITY	
Alaska		ALASKA STAT. §§ 21.36.010 to 21.36.460 (2003/ 2011); § 21.42.130 (1996/1997).
American Samoa	NO CURRENT ACTIVITY	
Arizona	NO CURRENT ACTIVITY	
Arkansas	054.00.101 ARK. ADMIN. CODE §§ 1 to 7 (2013) (disability income protection).	
California		CAL. INS. CODE § 10110.6 (2011); LETTER OPINION 2-26-2004 (2004); INS. DEP'T NOTICE 2-27-2004 (2004).
Colorado		COLO. REV. STAT. § 10-3-1116 (2) (2008).
Connecticut		HEALTH CARE BULLETIN HC-67 (2008).
Delaware	NO CURRENT ACTIVITY	
District of Columbia	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Florida	NO CURRENT ACTIVITY	
Georgia	NO CURRENT ACTIVITY	
Guam	NO CURRENT ACTIVITY	
Hawaii		HAW. REV. STAT. ANN. §§ 431:13-101 to 431:13-108 (1987); MEMORANDUM 2004-13H (2004).
Idaho		IDAHO ADMIN. CODE r. 18.01.29.000 to 18.01.29.012 (2009).
Illinois	ILL. ADMIN. CODE tit. 50, § 2001.3 (2005).	BULLETIN 2010-5 (2010).
Indiana		BULLETIN 103 (2001).
Iowa	NO CURRENT ACTIVITY	
Kansas	NO CURRENT ACTIVITY	
Kentucky		ADVISORY OPINION 2010-01 (2010).
Louisiana	NO CURRENT ACTIVITY	
Maine		ME. REV. STAT. ANN. tit. 24-A, § 4303(11) (1995/2019) (managed care).
Maryland	MD. CODE ANN., INS. 12-211 (2011) (disability).	
Massachusetts	NO CURRENT ACTIVITY	
Michigan		MICH. ADMIN. CODE r. 500.2201 to 500.2202 (2007); 550.302 (2007).
Minnesota		MINN. STAT. § 62Q.107 (1998).
Mississippi	NO CURRENT ACTIVITY	
Missouri	NO CURRENT ACTIVITY	
Montana	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Nebraska	NO CURRENT ACTIVITY	
Nevada	NO CURRENT ACTIVITY	
New Hampshire		N.H. CODE ADMIN. R. ANN. INS. 401.04 (2008/2009).
New Jersey		N.J. ADMIN. CODE §§ 11:4-58.1 to 11:4-58.4 (2007).
New Mexico	NO CURRENT ACTIVITY	
New York		CIRCULAR LETTER 2006-14 (2006).
North Carolina	NO CURRENT ACTIVITY	
North Dakota	NO CURRENT ACTIVITY	
Northern Marianas	NO CURRENT ACTIVITY	
Ohio	NO CURRENT ACTIVITY	
Oklahoma	NO CURRENT ACTIVITY	
Oregon		OR. REV. STAT. § 742.005 (1991/1999).
Pennsylvania	NO CURRENT ACTIVITY	
Puerto Rico	P.R. LAWS ANN. tit. 26, §§ 9201 to 9204 (2011).	
Rhode Island		R.I. GEN. LAWS § 27-18-79 (2013); § 27-20.1-21 (2013) (dental); § 27-34.2-22 (2013) (long-term care).
South Carolina	NO CURRENT ACTIVITY	
South Dakota		S.D. ADMIN. R. 20:06:52:01 to 20:06:52:03 (2008).
Tennessee	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Texas		TEXAS CODE ANN. § 1271.057 (2011) (evidence of coverage); § 1701.062 (2011); 28 TEX. ADMIN. CODE §§ 3.1201 to 3.1203 (2010).
Utah		BULLETIN 2002-7 (2002).
Vermont	VT. STAT. ANN. tit. 8, § 4062f (2011).	
Virgin Islands	NO CURRENT ACTIVITY	
Virginia	NO CURRENT ACTIVITY	
Washington		WASH. ADMIN. CODE 284-44-015 (2009) (health care); 284-46-015 (2009) (health maintenance organizations); 284-50-321 (2009) (disability); 284-96-012 (2009) (group).
West Virginia	NO CURRENT ACTIVITY	
Wisconsin	NO CURRENT ACTIVITY	
Wyoming		WYO. STAT. ANN. §§ 26-13-301 to 26-13-305 (2009).

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This model was developed in conjunction with efforts by the NAIC to clarify to states that they possess the authority to prohibit discretionary clauses in insurance contracts. **2001 Proc. 4th Quarter Vol. I 214.**

One Commissioner asked if there was a possibility that this model would be preempted by ERISA and Commissioner Larsen responded that states are not preempted by ERISA in prohibiting the use of discretionary clauses in insurance contracts because under ERISA states are free to regulate insurance, including the contents of insurance contracts. **2002 Proc. 1st Quarter Vol. I 12.**

One Commissioner said his state would have an external grievance law on the books in a month. He asked how this worked with a discretionary clause. Another Commissioner said that states that have external review provisions have already taken the position that they will not allow carriers to make all decisions. Another Commissioner agreed, opining that the grievance procedure law trumps the discretionary clause. Another Commissioner said this model provides an important consumer protection. There is not one shred of evidence as to how this would increase costs. **2002 Proc. 1st Quarter Vol. I 12.**

A few Commissioners voiced concerns about costs to employers, but did not object to the adoption of the model. **2002 Proc. 1st Quarter Vol. I 14.**

One commenter stated wondered if this model would cause a disadvantage regarding self-funded plans, and whether it would encourage a shift to self-funding. Another commenter responded that in the event of litigation, the discretionary clause caused the policy to be construed against the consumer, the opposite of normal contract interpretation, which is to be construed against the drafter. On the second question, the commenter said that goes to the cost issue, and there was no evidence proffered by industry that any costs were involved. In any event, these cases are the ones most likely to go to external review, which undercuts the cost argument. **2002 Proc. 1st Quarter Vol. I 175.**

A number of associations voiced that they opposed the adoption of the model. A few stated that they believed the model conflicted with ERISA, while others argued that the model would increase costs. On the other hand, a number of commenters supported the model. **2002 Proc. 1st Quarter Vol. I 175-76.**

The advisory committee had requested staff to draft amendments to that model act to prohibit the use of discretionary clauses in disability income insurance as well as health insurance. **2004 Proc. 3rd Quarter Vol. I 673.**

One comment expressed the opinion that an amendment to the model act was perhaps not the best way to solve the problem. He did not think that defining disability was an issue for the courts. He believed that regulators, through market conduct examinations, should be determining that the companies are paying what they should be paying. **2004 Proc. 3rd Quarter Vol. I 674.**

One comment opined that if a dispute arises, the dispute would end up in the courts one way or another. He stated that the use of a discretionary clause limited the courts' options regarding review of the dispute. Another commenter then asked whether mandatory external review could accomplish the same task. Another commenter expressed that when the judge gets a case with an arbitrary and capricious standard the judge is constrained in his analysis. Operationally what occurs is when the threshold of proof is reduced; companies will limit the amount of investment they make in their claims department. The inclination then is to have less medical review and resources expended; therefore, the management of claims is reduced. **2004 Proc. 3rd Quarter Vol. I 674.**

One Commissioner questioned whether the end result of a prohibition would be an increase in litigation. Another Commissioner indicated the cases would still be adjudicated under ERISA which has a limited remedial scheme. The litigation process would be the same except for a different standard of review. Another Commissioner stated the prohibition would give a plaintiff a greater ability to prove his or her case, and another commenter stated it gave a judge the opportunity to have a fresh look at the facts. **2004 Proc. 3rd Quarter Vol. I 674.**

One commenter stated that the cost of medical malpractice insurance has been a concern and he was interested in the cost issue; however, he indicated he was supporting the amendments to the model. **2004 Proc. 3rd Quarter Vol. I 674.**

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An ACLI commenter stated she did not believe the absence of the clause would affect the outcome of the cases. She said it would increase litigation costs because cases would take longer. One commenter questioned the claims handling aspect of a prohibition and questioned whether the files would be better documented without a discretionary clause. Another commenter disagreed that claims handling was poor in the first instance. One Commissioner reiterated that when he was in private practice he noticed a pattern that when the clause was in effect, the files were thinner and it took very little to uphold the finding. Another Commissioner noted that another result of having a prohibition is operational uniformity. **2004 Proc. 3rd Quarter Vol. I 674.**

One Commenter stated a professor at the John Marshall Law School in Chicago, did a full review of cases from 1993 through 2003. His findings were markedly different from those of ACLI and in fact plaintiffs under a de novo review won 68% of cases versus those with an arbitrary capricious standard of review won only 28% of cases. She also stated that the numbers do not reflect the true reality. If there is a de novo standard of review, the case is much more likely to settle. Also, with the arbitrary and capricious standard, there are really two lawsuits: The first is process litigation, determining what standard of review you get; then onto a suit on the merits. She stated it is hard to get attorneys to take these cases because due to ERISA's remedial scheme, there are no punitive damages or any damages beyond the cost of the service. She also indicated that the Department of Labor does not have any particular consumer assistance process in this regard. **2004 Proc. 3rd Quarter Vol. I 674.**

One commenter argued that a Supreme Court case, *Aetna v. Davila*, taken together with other cases, invalidated the ability of the state to prohibit the use of discretionary clauses. He argued that if there is some kind of state option that duplicates an ERISA remedy, it is preempted. In this instance, prohibiting the use of the discretionary clause is taking discretion away from the fiduciary. He suggested that the NAIC should retain counsel for opinion on whether the *Davila* case preempted the NAIC's efforts. One Commissioner stated that he saw no reason for delay. Another Commissioner noted that the *Davila* case is about remedies under ERISA, not about a discretionary standard. Nothing in the *Davila* case overrules prior Supreme Court dicta that discretionary clauses can be prohibited by the state. He believed that in the course of ERISA litigation, the Supreme Court has gotten to the point where it is essentially stating that ERISA is an exclusive scheme of remedies, period. An AARP representative stated that the *Davila* case is strictly a remedies case. The *Davila* was clear that the states could prohibit the use of discretionary clauses. **2004 Proc. 3rd Quarter Vol. I 675.**

Section 1. Short Title

Section 2. Purpose and Intent

The working group discussed including a drafting note in the model act that clarifies the purpose of the model act and the authority of the states, under ERISA's saving clause, to prohibit the use of discretionary clauses in insurance contracts. The drafting note might also clarify why the model act does not conflict with the Supreme Court decision in *Firestone*. **2001 Proc. 4th Quarter Vol. I 215.**

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2001 Model adopted
2002 Model adopted
2004 Model amended
2004 Model adopted

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