PROJECT HISTORY – 2004

PROHIBITION ON THE USE OF DISCRETIONARY CLAUSES MODEL ACT (#42)

1. Project Description

In 2002, the NAIC adopted the Prohibition on the Use of Discretionary Clauses Model Act (Model Act), which prohibits the use of such clauses in health insurance contracts. At the 2004 Spring National Meeting, the Consumer Protections Working Group of the Executive (EX) Committee decided that a public hearing should be held in conjunction with the Health Insurance and Managed Care (B) Committee during the 2004 Summer National Meeting. The hearing was intended to create a forum for interested parties to discuss whether the NAIC should expand the Model Act to include disability income insurance. The public hearing resulted in a request that staff draft amendments to the model act to prohibit the use of discretionary clauses in disability income insurance as well as health insurance for consideration by the Health Insurance and Managed Care (B) Committee. The draft amendments to the Model Act were adopted unanimously by the B Committee at the 2004 Fall National Meeting.

2. Group Responsible for Drafting Model and States Participating

The Health Insurance and Managed Care (B) Committee was responsible for drafting the Model Act, chaired by Commissioner Praeger. The following states were members of the Committee: Kansas, Montana, Arizona, Arkansas, California, Delaware, Florida, Georgia, Indiana, Maryland, Missouri, Wisconsin, and West Virginia.

3. Charge Authorizing Project

B Committee Charge: Monitor, report, and analyze developments related to ERISA, and make recommendations regarding NAIC strategy and policy with respect to those developments. Report quarterly.

4. Description of Drafting Process

2004 Spring National Meeting – The Consumer Protections Working Group of the Executive (EX) Committee Health Insurance and the Managed Care (B) Committee decided that a joint public hearing should be held at the 2004 Summer National Meeting.

2004 Summer National Meeting – A joint public hearing of the Consumer Protections Working Group of the Executive (EX) Committee and Health Insurance and Managed Care (B) Committee was held. The following individuals testified at the hearing: Mary Ellen Signorille (AARP Foundation, Litigation); Terri Sorota (American Council of Life Insurers—ACLI); Richard E. Ramsay (America's Health Insurance Plans—AHIP); Brad Wegner (Association of California Life and Health Insurance Companies); Sonya Schwartz (Families USA); Mila Kofman (Georgetown University—Health Policy Institute); Teresa S. Renaker (Lewis & Feinberg, P.C.) and clients Joanna Baida, Mark Rosten, and Gregory Rowe; Ruth Silver Taube (Silver & Taube); Melvyn D. Silver (Silver & Taube); Lawrence Frank (Standard Insurance Company); Karrol Kitt (The University of Texas at Austin); and Cathey W. Steinberg (Women's Policy Group, Women's Policy Education Fund). Testimony and written submissions were collected and are included as part of the written record of the hearing. Following the hearing, staff was directed to draft and circulate amendments to the Prohibition on the Use Of Discretionary Clauses Model Act for consideration by the Health Insurance and Managed Care (B) Committee at the 2004 Fall National Meeting

August 2004 – Draft amendments were emailed to the B Committee and interested parties. Comments were requested. Comments were collected and emailed to B Committee and interested parties prior to the 2004 Fall National Meeting.

2004 Fall National Meeting – Draft amendments and comments were reviewed. After discussion in which regulators and interested parties participated, the B Committee unanimously voted to adopt the revisions to the model act.

Significant Issues Raised

- The current Prohibition on the Use of Discretionary Clauses Model Act prohibits the use of discretionary clauses in health insurance contracts. The inclusion of discretionary clauses in disability income insurance policies is as objectionable as their inclusion in health insurance policies.

- Insurers argued that a recent Supreme Court case, *Aetna v. Davila*, taken together with other cases, invalidated the ability of the state to prohibit the use of discretionary clauses. The *Davila* case, however, is about remedies under ERISA, not about a discretionary standard. Nothing in the *Davila* case overrules a prior Supreme Court opinion that states that discretionary clauses can be prohibited by state law.

PROJECT HISTORY – 2002

PROHIBITION ON THE USE OF DISCRETIONARY CLAUSES MODEL ACT (#42)

1. Project Description

The working group reviewed the practice and case law on the issue of insurers using discretionary clauses in their insurance contracts. The ERISA Working Group agreed to develop a draft model act prohibiting the use of discretionary clauses in health insurance contracts.

2. Group Responsible for Drafting Model and States Participating

The ERISA Working Group of the Health Insurance & Managed Care (B) Committee was responsible for drafting the model. Wisconsin chaired the working group. The following states were members of the working group: Delaware, Florida, Illinois, Iowa, Kansas, Louisiana, Minnesota, Montana, Nebraska, Nevada, New Jersey, North Carolina, Pennsylvania, Texas, Utah, Vermont, Virginia, Washington and West Virginia.

3. Charge Authorizing Project

Working Group Charge: Monitor, report, and analyze developments related to ERISA, and make recommendations regarding NAIC strategy and policy with respect to those developments. Report quarterly.

4. Description of Drafting Process

March 2001 National Meeting—ERISA WG reviews documents regarding issue in closed session (Indiana had reviewed issue; confidential document was provided to regulators). ERISA WG asked staff to draft a memorandum for next national meeting.

June 2001 National Meeting—ERISA WG reviews memorandum and agrees to develop a model act prohibiting such clauses. Reported to B Committee.

December 2001 National Meeting—ERISA WG reviews draft model act and comments received. Further comments requested. Reported to B Committee.

March 2001 National Meeting—ERISA WG recommends adoption of model to B Committee. B Committee adopts model. Interested parties comment at both meetings.

Significant Issues Raised

- Discretionary clauses purport to give an insurance company full and final discretion in interpreting benefits and administering an insurance contract.

- Circuit Courts of Appeals have generally concluded that courts must give deference to claims decisions by insurers **when** insurance contracts confer discretion to the insurer to interpret the terms of the contract. Consequently, it is an industry practice to use the clauses in contracts.

- Regulators found this particularly troubling given that most of the courts recognize that there is a substantial conflict of interest between the carrier's financial interest in deciding claims and the interest of claimants in obtaining coverage. Such an inherent conflict of interest makes the reservation of complete and final discretion to the insurer patently unfair and a de novo standard of review appropriate for the review of insurer's claim decisions.

- Several states have concluded that the inclusion of discretionary clauses in insurance contracts is considered inequitable, deceptive and misleading to consumers.

- Insurers argued that the model act is preempted under ERISA. However, 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.

- Insurers also argued that the model act will result increased litigation and health care costs. However, several states currently prohibit the use of discretionary clauses and industry failed to present evidence of a resulting increase in litigation or rise in the cost of health insurance in those states. In fact, prohibiting discretionary clauses has no effect on who may file a lawsuit, or when. Furthermore, as regulators pointed out, the majority of carriers pay claims that should be paid, and therefore it is only a small number of claims that are disputed. The claimant needs to show by a preponderance of the evidence that the claim should be paid. Plaintiffs can show this now, but with the presence of a discretionary clause, get thrown out of court because there is no abuse of discretion.