

**INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE**

**Actuarial Services
Prohibition of Discretionary Clauses**

Adopted New Rules: N.J.A.C. 11:4-58

Proposed: August 21, 2006 at 38 N.J.R. 3227(a)

Adopted: April 11, 2007 by Steven M. Goldman, Commissioner, Department of Banking and Insurance

Filed: April 12, 2007 as R. 2007 d.152, **with a substantive change** not requiring additional public notice and opportunity or comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-8.1, 17:1-15(e), 17B:25-18(h), 17B:25-18.1, 17B:26-1h(2), 17B:27-25(g), 17B:27E-10, 17:29B-1 et seq., and 26:2S-12c

Effective Date: May 7, 2007

Expiration Date: March 14, 2011

Summary of Public Comments and Agency Responses:

The Department received comments from the following: the New Jersey Association of Health Plans (NJAHP); America's Health Insurance Plans (AHIP); the American Council of Life Insurers (ACLI); American International Group; Inc. (AIG); AIG American General and AIG Benefit Solutions; the Association of Trial Lawyers of America; New Jersey Professional Insurance Agents (NJPIA); law offices of Uscher, Quiat, Uscher & Russo; Bonny G. Rafel, LLC; Stephen T. Ruff; Rocet Sanchez; Carolyn Le; Naima A. Ellis; Michael S. Ruff; Michael C. Kazer, Esq.; Kim DiSerio; Linda J. Soden; Elizabeth Kronisch; William A. Teltser; James Docherty; Helaine Wolberg; Jeffrey Heillman; Annette Parks; E. Carlton Kramer, Esq.; Lori A. Johnson; Eva Gossman; Thomas M. Comer; Michael D. Schottland; Ramse M. Santarmen; Daniel S. Gichhorn; H. Frank Carpentier; Donna Bail; Marlene Ahde; Tabitha Vinson; Jennifer

Grieve; Howard R. Crain; Isabel A. Loffredo; Peter V. Koenig; Louise Haas; Jennifer Navez; Christine Sullivan; Simon Kaufman; Anne Bromberg; Deborah Pellicano; Debbie Capraice; Joseph Musso; Bernadette Frederick; Debra Maddox; Robert A. Greenberg; William T. Stoppur; Edward A. Lopez; Jeffrey Schaefer; Erica J. Musso; Lee Morgan Poli; Robert B. Goldstein; David J. Gruban; Bruce Rafel; Lewis Rafel; Mary Pat Moriarty, Esq.; Philip A. Tortoreti; James S. Schesly; Glenn Kaplan; Mark S. Tepper; Henry L. Furst; Diane Manatch; Robert R. Levinson; Daniel E. Chase; Paul E. Newell; Candace L. Birkenhauer; Frances A. Tomes; Susan Callahan; Erica Fiocco; Carolyn M. Lita; Lisa M. Schneider; Randi Lefbowitz; Kimberly S. Dawbner; Theresa Oriente; Teresa Faust; Walter L. Faust; Pino DiStefano; Patrick E. Murphy; Angela C. Holt; Anthony Piazza; Philip J. Schrader; Catherine Gutknecht; Jay Weinstock; Anthony Picerni; Christina R. Hewes; Marc E. Leder; Irving J. Brand; Audrey Young; Amos Gern; Richard T. Welch; Ronald L. Davison; Jeffrey A. Rizaka; Allan R. Mordkoff; Debora A. Murgatroyd; Anthony J. Murgatroyd; Daniel Schwarz; Marlo A. Vega; Arthur Steinman; Russell Zwawel; Karen Reider; Lawrence Van Nost; Sharon L. Burke; James Ferrentino; Jesse DiTeodoro; F.T. Deave, M.D.; Marc E. Komorsky; Elizabeth Gutierrez; Marian F. Francis; Susan L. Bishop; John Pelligra, M.D.; Regina Herbek; Randy W. Edwards; Timothy P. Zain; Diane Venus; Elena Weitz; Charles D. Melita; Michael Saxon; Jennifer Jacks; Gail Covey; Carol Ipu; Margaret M. Grande; John T. Brost; Maureen L. Goodman; Ann Marie Korzeb; Jean Koczka; Catherine M. Murphy; Lisa Korzeb; Sara R. Evans; Aurora Palmisano; Victor I. Macam; Brian R. Goodman; Robert Goodman; Nancy Bryant; Louis A. Lorenzo, Jr.; Joyce S. Ackironman; Robert M. Adochio; Francisco J. Rodriguez; Paul A. Sochanchak, Esq.; Andrew H. Graulich, Esq.; Diane G. Shaw; Donald A. Caminin; Shannon Deitz; Jemma Flanigan; Kimberly A. Hoehing; Francis J. Deitz; David Cedar; Jeffrey Grudko; Brian E. Ansell, Esq.; Victor Cruz;

Harriet Howell; Dolores E. Marshall; Victoria A. Kingdon; Eileen Scheid; Lucia Petullo; Virginia S. Minster; Joanne McCobb; Thomas L. Ferro; Thomas E. Artz; Judith A. Artz; Laura A. Vizzli; Patricia Grad; J.S. Grad; Maria Levy; Lana Ziesemer; Andrew Venturelli; Michael Thompson; Adam R. Glinn; Elisa Glinn; Sharon Huddy; Sean Garguilo; Thomas Resta, Jr.; John Lynch; Howard Jacks; Marilyn Jacks; Glen J. Bloustein; Donald E. Faistl; and Kathy Padulano.

COMMENT: Approximately 189 consumer commenters expressed their support for the Department's proposal. The commenters stated that the inclusion of discretionary clauses in insurance policies unjustly insulates insurance companies from a review of their actions by our court system. The commenters requested that the State adopt the proposed rules and declare that discretionary clauses are contrary to New Jersey law and prohibited, and that any forms containing such clauses be disapproved and that prior approval of any forms containing such clauses be withdrawn.

RESPONSE: The Department thanks the commenters for their support.

COMMENT: Four additional commenters expressed their support for the proposal. Two commenters stated that the language of discretionary clauses makes eligibility for benefits contingent on the insurer's discretion, rendering the policy ambiguous at best and illusory at worst. The commenters stated that the new rules will have a favorable impact on consumers by applying a de novo standard of review for policy interpretations and benefit determinations rather than the arbitrary and capricious standard applied when a discretionary clause is included in a policy. Under the arbitrary and capricious standard, policy interpretations by the insurer will be reviewed only as to whether they are unreasonable and not whether they are in accordance with New Jersey insurance law and rules of contract construction. The commenters further stated that discretionary clauses violate New Jersey insurance laws because they purport to give

an insurer unfettered discretion to determine benefit eligibility and/or interpret policy terms and conditions; cause the policies to be ambiguous, misleading, unjust, unfair, inequitable and affect the risk purported to be assumed in the general coverage of the policy; significantly limit the ability of policyholders to collect benefits otherwise payable under the policies and thus the benefits provided are unreasonable in relation to the premium charged; are deceptive because they give the impression to a policyholder that the insurer's decision or interpretation is final and binding when it is for courts applying the rule of law and accepted rules of construction to make such final decisions and interpretations; and make coverage illusory because they make the eligibility of the policyholder uncertain and dependent on the unlimited discretion of the insurer rather than on the terms of the policy or facts surrounding the policyholder's disability.

RESPONSE: The Department agrees with the reasons noted by the commenters for prohibiting carriers from including discretionary clauses in policies and contracts. It is the Department's intention in adopting these rules that carriers will not have the sole discretion to interpret the terms of a policy or contract, and that covered persons are able to exercise their appeal rights in accordance with applicable State and Federal laws.

COMMENT: Two commenters stated that, while the Department has stated that it prohibits the inclusion of discretionary clauses in all life and health insurance policies and contracts, including disability insurance contracts, a sampling of the companies' policies approved by the Department in the past several years indicates otherwise. Some approved products contain language that provides companies with discretionary review. One of the commenters included samples of such policies issued by five different companies.

RESPONSE: The Department has been disapproving policies and contracts containing discretionary clauses for several years. Nevertheless, it is likely that some older policies and

contracts containing such clauses remain in effect. Upon adoption of these new rules, however, the use of discretionary clauses will be prohibited; further, as of January 1, 2008, all non-complying forms shall be deemed withdrawn.

COMMENT: One commenter stated that, while the Department may have taken the position that discretionary clauses are already void as a matter of public policy, the courts in New Jersey do not recognize that public policy and that, absent adoption of these proposed rules, the State does not appear to have achieved implementation of its public policy and discretionary clauses continue to be utilized and enforced by the courts in the State of New Jersey. The commenter cites a United States District Court case for the District of New Jersey, *Sarlo v. Broadspire Services, Inc.*, 439 F. Supp. 2d 345 (D.N.J. 2006).

RESPONSE: As stated in response to a comment above, it is the Department's intention in adopting these rules that carriers will not have the sole discretion to interpret the terms of a policy or contract, and that covered persons are able to exercise their appeal rights in accordance with applicable State and Federal laws. Adoption of these new rules constitutes the formal expression of the Department's policy regarding discretionary clauses.

COMMENT: Five comments concerned the Department's proposed prohibition of discretionary clauses that confer on carriers "sole" discretion to determine eligibility for benefits and to interpret the policy. One commenter stated its concern that use of the term "sole" may provide carriers a loophole through which they may feel entitled to continue to use discretionary clauses on the theory that they do not have "sole discretion," but rather only such discretion that is not "arbitrary and capricious."

Four commenters requested clarification regarding the circumstances under which the Department would continue to permit carriers to use discretionary clauses, thus allowing carriers

to fulfill their fiduciary duties as required by the Employee Retirement Income Security Act of 1974, as amended (ERISA). One commenter stated that some approved products contain terms in which the companies retain “sole discretion” over certain activities (for example, allowing a company to make payments under a policy when no beneficiary is living, and allowing a company to make payments which are required in order to preserve the tax qualified status of the policy under the Federal tax laws), and requested that the Department provide guidance and concrete examples of what constitutes a “prohibited” discretionary clause. One commenter suggested clarification that the proposed rule is not intended to prohibit carriers from including clauses asserting the carrier’s discretion to interpret the contract so long as it does not attempt to confer upon the carrier the “sole,” “exclusive” (or other words attempting to describe a singular role) discretion to determine eligibility for benefits or the meaning of the contract or conflict with appeal processes required under applicable state law.

RESPONSE: The Department’s rules would permit carriers to use discretionary clauses in their policies and contracts so long as those clauses do not provide carriers with sole discretion to interpret the terms of the policy or contract or are inconsistent with appeal processes required under applicable law. The Department does not believe it is necessary to provide further clarification regarding, or concrete examples of, circumstances under which discretionary clauses may be used. The rules allow discretionary clauses that permit carriers to make initial interpretations regarding the terms of their policies and contracts subject to applicable state and federal laws.

COMMENT: One comment concerned non-complying forms. The commenter stated that the refiling of forms previously approved by the Department would be time consuming and laborious for both the Department and insurers. The commenter suggested grandfathering policy

forms that were previously approved. Alternatively, in an effort to relieve some of the burden related to the aggressive January 1, 2007 compliance date, the commenter requested that the Department allow the insurer to certify that it will not rely on the company's discretion in certain cases or allow removal of prohibited discretionary clauses through use of an endorsement approved by the Department.

RESPONSE: As proposed, the provision in question deemed withdrawn after January 1, 2007 all newly issued or renewing policy and contract forms that contain noncompliant discretionary clauses. Refiling noncompliant forms is not required. Further, given the timing of the adoption of these rules, the proposed January 1, 2007 withdrawal date is being extended to January 1, 2008.

COMMENT: One commenter questioned whether the proposed rules apply to credit insurance, specifically such products as group credit life, group credit disability, group credit dismemberment, group mortgage life, group mortgage disability, group mortgage accidental death, individual credit life, individual credit disability, individual mortgage life, and individual mortgage disability.

RESPONSE: The rules apply to credit insurance because those policies and contracts are considered subcategories of life and health insurance (See N.J.S.A. 17B:29-1 *et seq.*)

Federal Standards Statement

A Federal standards analysis is not required because the Department's adopted new rules are not subject to any Federal standards or requirements.

Full text of the adopted new rules follows (additions to proposal indicated in boldface with asterisks ***thus***; deletions from proposal indicated in brackets with asterisks *[thus]*):

11:4-58.4 Noncomplying forms

As of *[January 1, 2007]* ***January 1, 2008*** , forms previously filed, approved or acknowledged by the Commissioner that contain provisions not in compliance with this subchapter shall be deemed withdrawn and shall not be delivered, issued, executed or renewed.

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