

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 236 (Chair, Health and Government Operations Committee) (By
Request – Departmental – Insurance Administration, Maryland)
Health and Government Operations

**Life or Health Insurance Policies and Contracts - Discretionary Clauses -
Prohibition**

This departmental bill prohibits insurance carriers from selling, delivering, or issuing a life or health insurance policy or annuity contract that contains a clause that purports to reserve discretion to the carrier to interpret the terms of the policy or contract, or to provide standards of interpretation or review. Under the bill, such “discretionary” clauses are deemed void and unenforceable. The bill defines a carrier as an insurer, a nonprofit health service plan, or a health maintenance organization.

Fiscal Summary

State Effect: Special fund revenues would increase minimally in FY 2009 due to insurance carriers being required to file new insurance applications with any existing discretionary clauses removed. The cost of filing one such form with the Maryland Insurance Administration is \$125, but it is not known how many forms would be filed as a result of the bill. The bill’s requirements could be handled by MIA with existing budgeted resources.

Local Effect: None.

Small Business Effect: MIA has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

Current Law: Maryland law is currently silent on the use of discretionary clauses in life and health insurance policies, including disability policies and annuity contracts.

Background: Discretionary clauses in insurance contracts generally purport to reserve to the insurance carrier the full discretion to determine when insurance benefits under a contract are due. A number of states have restricted the use of such discretionary clauses in an effort to assure that insurance benefits are contractually guaranteed. One impetus behind such efforts is the concern that a conflict of interest may arise when an insurance carrier responsible for providing benefits also has discretionary authority to decide what benefits are due. Another important factor is the standard of review that a court must apply when a discretionary clause is present in an insurance contract. For example, when denial of benefits under a health insurance contract subject to the federal Employee Retirement Income Security Act becomes the subject of a lawsuit, a court reviews the case *de novo* after consideration of all available evidence of entitlement. When a contract contains a discretionary clause, however, the court is bound by a more stringent arbitrary and capricious standard that prevents the court from considering all available evidence and issuing a decision based on its own judgment. Instead, the court may only issue a ruling different from the insurance carrier's decision if the carrier's decision is found to have been unreasonable and an abuse of discretion.

The National Association of Insurance Commissioners (NAIC) has advocated prohibition of discretionary clauses in life, health, annuity, and disability insurance contracts by promulgating a model law, which has been adopted by several states. Other states have established regulatory rules and administrative authority to prohibit discretionary clauses. States that have restricted the use of discretionary clauses include California, Hawaii, Illinois, Indiana, Michigan, Montana, New Jersey, New York, Oregon, and Utah. The bill is based on the NAIC model law.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Health and Mental Hygiene; Maryland Insurance Administration; Department of Legislative Services

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