



Illinois Department of Insurance

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TO: ALL ENTITIES AND INDIVIDUALS REGULATED BY
THE ILLINOIS INSURANCE DEPARTMENT

FROM: MICHAEL T. MCRAITH, DIRECTOR OF INSURANCE *MTM*

DATE: JUNE 28, 2010

RE: COMPANY BULLETIN 2010-05

PROHIBITION ON DISCRETIONARY CLAUSES

This advisory provides notice to all entities and individuals regulated by this Department that are engaged in the issuance of accident, health or disability insurance policies in this State.

Insurance regulations prohibit accident, health, and disability insurance policies issued in Illinois from containing provisions reserving discretion in the insurer to interpret the terms of the contract. Section 2001.3 of Title 50 to the Illinois Administrative Code (50 Ill. Admin. Code 2001.3) provides as follows:

Section 2001.3 Discretionary Clauses Prohibited

No policy, contract, certificate, endorsement, rider application 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 or of a disability 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.

(Source: Added at 29 Ill. Reg. 10172, effective July 1, 2005)

It has come to the attention of the Department that, with respect to insurance policies originally issued before the July 1, 2005 effective date of the regulation, certain insurers continue to exercise discretionary clauses against their policyholders. Typically this is done under the theory that the regulation has no retroactive application. Such conduct does not comply with the law in that it does not properly take into account the renewal of the policy.

Policies offering accident, health and disability benefits typically are renewed annually. The Department's regulation prohibiting discretionary clauses was adopted five years ago next month. It is therefore unlikely that there are any policies in existence that have not been either renewed or issued subsequent to the effective date of the regulation.

Illinois case law requires that statutory provisions in effect at the time of issuance or renewal are incorporated into the policy: When an insurance policy is issued or renewed, applicable statutory provisions in effect at the time are treated as part of the policy. Eipert v. State Farm Mutual Automobile Insurance Company, 189 Ill.App.3d 630, 637, 545 N.E.2d 497, 501 (1st Dist. 5th Div. 1989). It is clearly the law of this State that a contract of annually renewable insurance forms a new contract at each renewal for the purpose of incorporating into the contract statutory provisions enacted after the creation of the original contract relationship. Thieme v. Union Labor Life Insurance Company, 12 Ill.App.2d 110, 115, 138 N.E.2d 857, 860 (1st Dist. 2nd Div. 1956). Correspondingly, whatever version of the applicable statutory provisions is in force when the policy is issued or renewed determines any questions arising under that policy and is normally controlling throughout the policy's term. Boyd v. Madison Mutual Insurance Co., 146 Ill.App.3d 420, 425, 496 N.E.2d 555, 558 (5th Dist. 1986).

This rule of law requiring incorporation of existing statutes into the policy upon issuance or renewal also applies to administrative rules and regulations. Administrative rules and regulations have the force and effect of law, and must be construed under the same standards which govern the construction of statutes. People v. ex rel. Madigan v. Illinois Commerce Commission, 231 Ill.2d 370, 380, 899 N.E.2d 227, 232 (2008). Similarly, it has long been held that administrative rules have the force of statute. Williams v. New York Central R. Company, 402 Ill. 494, 501, 84 N.E.2d 399, 403 (1949). Since insurance policies are deemed to incorporate statutory provisions in force when the policy is issued or renewed, and administrative rules have the force of statute and are governed by the same standards of construction, issuance or renewal of an insurance policy also incorporates into the policy administrative rules and regulations in force at the time the policy is issued or renewed.

The regulation prohibiting discretionary clauses is accordingly applicable to all currently issued and outstanding accident, health, and disability insurance policies in that all such policies will have either been issued or renewed since the effective date of the regulation. Insurers who do not comply with the absolute prohibition on discretionary clauses contained in 50 Ill. Admin. Code 2001.3 will be held accountable and subject to regulatory action.