LLB&L Client Alert

April 2, 2010

Significant Changes to Rescission of Health Insurance Policies in Illinois

Authors

R. Dean Conlin
312-443-0454
rdconlin@lockelord.com

Timothy S. Farber
312-443-0532
tfarber@lockelord.com

Rescission of health insurance policies — or so called retroactive cancellation — occurs when an insurer cancels existing coverage on the grounds that the insurer was misled in issuing the policy. Such practices have received increased attention in Illinois as the state has more health insurance policy rescissions than any other state by the number of rescissions, and in per capita basis Illinois trails only New Mexico. The increased number of rescissions, along with the egregious facts surrounding some rescissions, has resulted in heightened scrutiny from regulators, doctors and plaintiffs' lawyers, who have described insurers as too quick to rescind coverage for ill insureds. The issue of rescission has received national attention in the health care debate and increased attention in a number of states, including Illinois. Currently the ability of health insurers to rescind polices is now under serious assault at both the federal and state level.

With the Patient Protection and Affordable Care Act (HR 3590) (the "Federal Act") signed by President Obama on March 23, 2010, Congress and the President enacted the most sweeping reform of the United States health care system since the creation of Medicare in 1965.[1] One such provision in the Federal Act, which goes into effect six months after signing (September 23, 2010), will prohibit rescissions of health insurance policies except in instances of fraud and intentional misrepresentation of material facts. The new federal rule also applies to self-insured plans (although such employer-based group plans, unlike individual or family policies, are much less susceptible to rescissions). In addition, the Illinois legislature has a bill pending that, as described below, would further limit the ability of insurers to rescind health care policies. To understand the impact the new laws would have in Illinois one must first understand the current laws impacting rescission of health care policies in Illinois.

Current Illinois Law Regarding Rescissions

Current Illinois law allows for rescissions to occur up to two years after a policy is first issued (the "contestability period"). The insurer may rescind a policy if it can demonstrate the insured has withheld material information or answered material questions incorrectly on an application that at the time of the original application would have resulted in the insurer:

- Denying coverage;
- Restricting the level or coverage as applied for; or
- Rating up the premium normally charged for the coverage as applied for.

Questions in an application for insurance such as "Are you in good health?" or "Are you free from disease or impairment?" may not be used alone to rescind the policy unless the false answers to such questions, along with the other evidence, clearly demonstrate justification for rescission of the policy. The false statement must materially affect either the acceptance of the risk or the hazard assumed by the insurer. While some states restrict insurer rescission to instances where the misrepresented or concealed information is directly related to the illness that produced the claim, most states, like Illinois, do not. Insurers defend such rescission practices as absolutely necessary in order to reduce fraud, which by some estimates reaches $100 billion annually.

If a claim is submitted within the policy's initial two-year "contestability period," as allowed under Illinois law, the insurer may initiate an investigation of the applicant's medical history and a close examination of his or her responses to the health questions on the original application. Some insurers have been criticized for using a minor, unintentional or unrelated discrepancy, or purported misrepresentation, as the

www.lockelord.com

This *Client Alert* is provided solely for educational and informational purposes. It is not intended to constitute legal advice or to create an attorney-client relationship. Readers should obtain legal advice specific to their enterprise and circumstances in connection with each of the topics addressed.

If you would like to be removed from our mailing list, please contact us at either unsubscribe@lockelord.com or Locke Lord Bissell & Liddell LLP, 111 South Wacker Drive, Chicago, Illinois 60606, Attention: Marketing. If we are not so advised, you will continue to receive *Client Alerts*.

Attorney Advertising

© 2010 Locke Lord Bissell & Liddell LLP

basis for a policy rescission. Illinois law currently provides the insurer with broad discretion in the ability to rescind. Some critics contend this allows insurers to engage in post-claim underwriting that results in the policyholder receiving less coverage than that for which he or she originally bargained. Furthermore, Illinois currently does not establish an evidentiary standard on which a rescission determination is to be based.

The issue of rescissions, which occurs primarily in the individual and family health insurance markets, led the Illinois Insurance Department (the "Department") to release a bulletin to all insurers on December 21, 2009, alerting insurers that if they rescind a policy and the consumer files a complaint with the Department, the insurer would be required to provide complete copies of its underwriting policies as part of the Department's review. According to a June 2008 report by health insurance advocacy group Families USA, only one state — Connecticut — required insurers to ask for the state insurance commissioner's permission to rescind a policy. According to the report, insurance departments in 18 states granted consumers a formal appeal process if their health insurance is rescinded, and another eight states said they would investigate if a consumer complained.

In our prior *Client Alert* we discussed rescission in California in the context of a state court decision affirming summary judgment in favor of Blue Shield of California in ruling that the insurer was entitled to retroactively cancel or rescind a policy of insurance based on material misrepresentations and omissions about the applicant's health history. Surprisingly, these statements were made on the application for insurance, which the insurer had neither endorsed nor attached to the policy of insurance as required by California law. *See* "California Appellate Decision Affirms Right of Health Insurers to Rescind Policies for Misrepresentation" California's largest insurers have paid millions in fines and settlements in recent years regarding the practice of rescinding some health insurance policies.

Changes at the Federal Level and Proposed Changes in Illinois

A proposed bill in the Illinois General Assembly (HB6156) (the "Proposed State Bill") introduced February 11, 2010, seeks to make it more difficult for all insurers to rescind a health insurance policy. The Proposed State Bill provides that no insurer shall rescind or cancel any policy of insurance, contract, evidence of coverage, or certificate that provides health coverage on the basis of written information by the insured "submitted on or with or omitted from an insurance application by the insured if the insurer failed to complete medical underwriting and resolve all reasonable medical questions related to the written information submitted on or with or omitted from the insurance application before issuing the policy, contract, evidence of coverage, or certificate." The Proposed State Bill also requires an insurer to apply for approval of a policy rescission or cancellation by submitting written information to the Department. The Department may approve the rescission or cancellation if it finds that the insured "performed an act or practice that constitutes fraud or made an intentional misrepresentation of material fact under the terms of the coverage." The Department will not approve a rescission if it is initiated after a claim is submitted by the insured unless the submitted claim bears a direct relationship to the intentional misstatement or fraud. These requirements in the Proposed State Bill do not apply to "short term, disability income, long-term care, accident only, or limited or specified disease policies." Significantly, in contrast to the requirement of regulatory approval of a rescission in the Proposed State Bill, the Federal Act simply prohibits rescission in prescribed circumstances.

As noted above, beginning September 23, 2010, the Federal Act will prohibit rescissions of health insurance policies except in instances of fraud and misrepresentation of material facts. In addition, insurers will be prohibited from denying claims for children under the age of 19 due to the presence of a preexisting condition. (This restriction will apply to those 19 and over on January 1, 2014). Policies issued on or after September 23, 2010 will have to comply immediately with these two reforms.

For policies issued between March 23, 2010, and September 22, 2010, the reforms will apply as soon as the policies are amended or renewed after September 23, 2010. Policies that were issued prior to March 23, 2010, are considered "grandfathered" plans, and while some reforms do not apply immediately to grandfathered plans, the prohibition against unwarranted rescissions does apply to immediately grandfathered plans.

Although our focus is on rescission, we note that the provisions regarding preexisting coverage for children apply to grandfathered group plans but not to grandfathered individual plans. Therefore, in Illinois, until full implementation of the Federal Act in 2014, insurers are permitted to reject an applicant of health insurance, including those under 19 years of age, on the basis of preexisting conditions.

LLB&L

Client Alert

April 2, 2010

Offices

Atlanta

Austin

Chicago

Dallas

Houston

London

Los Angeles

New Orleans

New York

Sacramento

San Francisco

Washington, DC

Significant Changes to Rescission of Health Insurance Policies in Illinois (cont'd.)

As we noted in our prior *Client Alert* entitled "Illinois Expands Availability of External Review in Enacting Significant Health Care Reforms," effective July 1, 2010, pursuant to a new Illinois law, all people in Illinois with health insurance are guaranteed the right to an independent, external review of claims denied by a health insurance company on the basis of a determination of "medical necessity." Those receiving health coverage through a self-insured employer, however, do not have the right to an independent review because such plans are exempt from the State's insurance laws. The new Federal Act will require all plans, including self-insured plans, to provide for an independent, external review of denied health insurance claims on September 23, 2010. Such external review requirements will not apply to grandfathered plans under the Federal Act.

The reforms in the health care area represent the most significant health care reforms in over four decades, and the impact on insurers and policyholders should not be underestimated. The complex federal legislation and its interplay with pending and enacted reforms at the state level help to create one of the more challenging regulatory environments in years. Insurers should be cognizant of both the scope of the changes and the timing of their enactments. We will continue to follow and analyze the impact of these reforms in assisting our clients in complying with regulatory changes at both the state and federal levels.

Endnotes

1 Congress also passed the Health Care and Education Reconciliation Bill of 2010 making certain changes to the Federal Act.

About the Authors

R. Dean Conlin is a partner at Locke Lord. He has more than 30 years of experience in a wide range of health care, insurance regulatory and corporate matters. Mr. Conlin has focused on managed health care since the early stages of preferred provider networks. His clients include regulated insurers and alternative risk vehicles that provide managed health care coverage. His work for these clients, including preferred provider organizations, has ranged from product development to regulatory counseling, including counseling on the impact of ERISA on managed health care. In addition, Mr. Conlin has organized insurers and reinsurers and counseled them on a full range of regulatory and corporate issues. In this connection, he leads our firm's longstanding representation of Old Republic International Corporation and American Fuji Fire and Marine Insurance Company. He also counsels Lloyd's Illinois, Inc., which is the corporate Illinois Attorney-in-Fact for Underwriters at Lloyd's, London.

Timothy S. Farber is an associate at Locke Lord. He practices in the area of corporate law, where his focus is on general corporate law, mergers and acquisitions, securities and insurance regulatory matters. Mr. Farber has experience representing issuers and underwriters in debt and equity financing matters for both public and private companies.

© 2010 Locke Lord Bissell & Liddell LLP