

TESTIMONY
OF THE
NATIONAL ASSOCIATION OF
INSURANCE COMMISSIONERS

BEFORE THE
SENATE FINANCE COMMITTEE

ON

**The Effect of Unauthorized Benefit Plans
on Employers and Individuals**

Presented by:

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Introduction

Good morning Mr. Chairman and members of the Committee. My name is Fred Nepple and I am General Counsel for the Wisconsin Office of the Commissioner of Insurance. I am also Chair of the National Association of Insurance Commissioners (NAIC) ERISA Working Group. It is in this capacity that I come before you today to discuss the NAIC's efforts to assist in the identification, elimination and prosecution of unauthorized health plans.

The NAIC represents the chief insurance regulators from the 50 states, the District of Columbia, and four U.S. territories. The primary objective of insurance regulators is to protect consumers. It is in furtherance of this goal that the NAIC has implemented several aggressive efforts to address the growing problem of unauthorized health plans.

The Problem

Unauthorized health plans that claim to provide comprehensive coverage at premiums a fraction of those charged by state licensed insurers seem like a dream to many employers and individuals struggling to afford or even obtain coverage. Unfortunately, the dream quickly becomes a nightmare.

Unauthorized health plans have had a destructive ripple effect, impacting every aspect of the health care system. Individuals and families, having paid thousands of dollars in premiums, are left with no coverage and mounting healthcare bills. Employers are left with no coverage for themselves and their employees and are often liable for their employee's unpaid bills. Consumers and healthcare providers are left with millions of dollars in unpaid claims. Authorized and licensed health insurers are left with a fractured marketplace and are deprived premium dollars that should have flowed to the legitimate market. State governments are left with uninsured residents who are not eligible to have their claims paid

through the state guaranty fund. If they cannot pass underwriting the only option may be a state high-risk pool. State governments also incur the substantial cost of investigating and prosecuting these fraudulent schemes.

The number and scope of unauthorized health plans have spiked as health insurance premiums have begun to rise at a double-digit pace. States and the federal government have been aggressive in their response, but the problem persists.

Types of Unauthorized Plans

All the unauthorized health plans discussed in the GAO report have two factors in common. They all offer a plan that claims to provide employee benefits subject to the Employee Retirement Income Security Act of 1974 (ERISA), and they all claim to be exempt from state insurance regulation under ERISA. Unauthorized health plans take several different forms. They typically claim to be unions, business associations, professional associations, out-of-state trusts, single-employer plans, or some combination.

The operators of unauthorized health plans know that employers and individuals generally go to authorities only after they realize that their claims will not be paid. The operators exploit this delay. By the time many illegal plans are identified their infrastructure has already collapsed and claims already exceed assets. They also rely on aggressive assertions of ERISA preemption to convince licensed agents and others to market their plans without alerting regulators. When operators are challenged by the state insurance regulators or the U.S. Department of Labor they commonly resist investigations and discovery with claims of ERISA preemption. They extend delays by claiming to have troubled information systems, poor claims records and inadequate accounting procedures. When states are forced to litigate against these plans, this causes further delay (especially given the complexities of ERISA

defenses), which affords them additional time to collect premiums and dissipate assets while unfunded claims mount.

NAIC Activities

To address the problem of unauthorized health plans the NAIC has implemented a variety of initiatives.

- *Points of Contact:* The NAIC maintains a list of contacts in every state, which is posted on its Web site. This list identifies an individual in every state insurance department who is familiar with the issue of fraudulent plans and can answer questions from the public and insurance agent community. This has proven to be an important tool for accelerating the identification of suspicious plans.

- *Bulletins for Consumer and Agent Education:* The NAIC has developed bulletins for use by state insurance departments to draw attention to the issue of fraudulent plans, and provide guidance. The NAIC distributed a “Consumer Alert” designed to warn consumers about “ERISA” and “union plan” scams, to suggest some “smart shopper” questions to ask and to advise consumers to report to their state insurance department any attempts by insurance agents to sell “union” plans. The NAIC also circulated an “Agent Alert” to remind agents of their duty to inform their state insurance department any time they are approached by a suspicious entity. Any agent who sells a sham “ERISA” or “union” plan should expect to lose his or her license and to face personal liability for any claims incurred under the unlicensed coverage. Enlisting the cooperation of the agent community has been critical to the early identification of illegal plans. The National Association of Health Underwriters took the responsible

step of publishing the alert in its magazine, and forwarded many leads to state insurance regulators.

- *Direct Consumer Education:* The NAIC has budgeted \$295,000 to initiate a National Media Campaign on unauthorized insurance. This effort has just begun and will run through June 2004. This project will include media campaign development, media production, media relations and web site development. As a first step in the campaign, the NAIC printed a brochure “Make Sure Before You Insure,” which identifies signs of potential fraud and ways consumers can protect themselves.

- *Information for Licensed Insurers:* The NAIC sent to all NAIC members in June 2003 the model bulletin, “Regulatory Alert to Stop Loss Carriers and Third Party Administrators.” The regulatory alert for licensed insurance plans emphasizes the key role that licensed entities play in state efforts to combat unauthorized health entities. In addition to insurance agents, illegal entities also solicit the assistance of state licensed stop loss carriers and third party administrators to lend legitimacy to their illegal operations. The regulatory alert reminds stop loss carriers and third party administrators that, as part of their commitment to good business practices, they are obligated to review their internal controls and business practices to ensure they do not become unwitting accomplices of illegal health insurance plans. Like agents, stop loss insurers and third party administrators may risk regulatory penalties and liability for unpaid claims under state law for doing business with unauthorized entities.

- *Information for Regulators:* The NAIC writes and distributes the *ERISA Handbook* (official title: *Health and Welfare Plans under the Employee Retirement Income Security Act: Guidelines for State and Federal Regulation.*) The Handbook, which is currently being updated by the NAIC ERISA Working Group, highlights for regulators the different types of unauthorized entities that seem to be most prevalent and provides additional guidance on recognizing and shutting down fraudulent plans.

- *Information Sharing Among States and the Federal Government:* The NAIC is involved in extensive efforts to coordinate information sharing among states and the Department of Labor on a persistent basis. Information is exchanged about suspect entities, individuals, third party administrators, agents, marketing firms, stop loss carriers, reinsurers, provider groups—essentially everyone involved in every aspect of what are often complex, convoluted and extensive scams. Over the years, states have become more focused on information sharing through these efforts. Information is also shared during the four annual NAIC meetings.

- *Interstate Coordination:* The NAIC facilitates information sharing and coordination among states where a particular scam is operating. Lead state insurance departments share critical information such as: (a) a list of insureds and where they are located; (b) a list of agents marketing the plans and where they are located; and (c) names of principals involved with the plan

- *Model Law:* The NAIC Antifraud Task Force, MEWA Subgroup, is drafting a model law making it a felony to transact unauthorized insurance. This model is intended to

encourage states to increase current criminal penalties, and ease prosecution, for operation of an illegal health plan.

Conclusion

Unauthorized health plans are a growing problem that negatively impacts the entire insurance and healthcare system. The NAIC works closely with the states and the federal government to facilitate the prevention, identification and elimination of unauthorized health plans, but we must remain vigilant. The NAIC applauds this committee for holding this hearing today and beginning a Congressional dialogue which we all hope will result in greater success in this ongoing battle against illegal health plans. We offer our assistance to the committee as this discussion continues and thank you for this opportunity to participate in today's hearing.