THIRD PARTY ADMINISTRATORS

Submitted By
The Colorado Department of Regulatory Agencies
June 1993

June 15, 1993

The Honorable Vickie Agler, Chairperson
Joint Sunrise/Sunset Review Committee
State Capitol Building
Denver, Colorado 80203

Dear Representative Agler:

We have completed our evaluation of the sunrise application for Third Party Administrators and are pleased to submit this written report which will be the basis for my office's oral testimony before the Sunrise and Sunset Review Committee. The report is submitted pursuant to section 24-34-104.1, Colorado Revised Statutes, the "Sunrise Act", which provides that the Department of Regulatory Agencies shall conduct an analysis and evaluation of proposed regulation to determine whether the public needs and would benefit from the regulation.

The report discusses the question of whether there is a need for the regulation in order to protect the public from potential harm, whether regulation would serve to mitigate the potential harm and, whether the public can be adequately protected by other means in a more cost effective manner.

Sincerely,

Joseph A. Garcia
Executive Director

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EXECUTIVE SUMMARY

The Department of Regulatory Agencies has reviewed the proposal to regulate third party administrators through occupational licensing administered by the Colorado Division of Insurance.

The Department recommends against regulation of third party administrators at this time. The fundamental assumption behind the applicant's proposal is that licensing can be used to protect the public from third party administrators. However, the evidence of problems or harm to the public from third party administrators does not meet the burden of proof required by Colorado's sunrise review process.

Instances of consumer harm involving third party administrators has been limited in scope. The Department has concluded that legislation recently passed in the 1993 session of the General Assembly may provide the Colorado Division of Insurance additional tools to combat specific problems in these areas. The Department finds that these laws should be given an opportunity to work before the state imposes licensing requirements on all third party administrators. Licensing is a more restrictive response by the state and could result in increased bureaucracy and increased costs.These costs are ultimately borne by consumers of insurance products. It is reasonable to first determine if recent legislative responses in Colorado will solve these problems before passing additional legislation.

I. INTRODUCTION

The Department of Regulatory Agencies has evaluated the proposal for regulation of Third Party Administrators. Pursuant to C.R.S. 24-34-104.1, the applicants must prove the benefit to the public of their proposal for regulation according to the following criteria:

1. Whether the unregulated practice of the occupation or profession clearly harms or endangers the health, safety, or welfare of the public, and whether the potential for the harm is easily recognizable and not remote or dependent upon tenuous argument;

2. Whether the public needs and can reasonably be expected to benefit from, an assurance of initial and continuing professional or occupational competence; and

3. Whether the public can be adequately protected by other means in a more cost-effective manner.

II. HARM TO THE PUBLIC BY THIRD PARTY ADMINISTRATORS

Third party administrators (TPA) are often employed contractually by insurance companies or self-insured plans to provide certain services. The services provided by a third party administrator can be varied. A couple of areas serve to illustrate the areas in which these administrators function and where they have the most potential impact on consumers.

First, a TPA may collect charges or premiums from consumers. In such cases, the consumers moneys are paid directly to a contract employee of the insurance company or other plan. Second, the TPA may be contracted to adjust or settle claims in connection with life, health, property or casualty insurance. Therefore, in such important areas, a consumer may be engaging in significant elements of insurance transactions, making payments and settling claims, without having any direct contact with a licensed insurance company.

In general terms, it is reasonable to conclude that these TPAs, by virtue of their contract with the licensed entity, fall under the regulatory authority of the Colorado Division of Insurance. However, the Division reports that in some investigations of consumer complaints, certain problems can be encountered with TPAs because all TPAs do not contract with a licensed insurer.

In some instances, a TPA may take the position that some information or documentation is under the jurisdiction of the Division and some is the property of the TPA. Since the TPA is not licensed, such posturing can delay the conduct of the investigation which may harm the consumer who filed the complaint. Further, continued harm to the public may occur as the TPA continues to do business allegedly outside of the oversight of the Colorado Division of Insurance.

In the Department's review of the proposal to regulate third party administrators, it became apparent that some third party administrators are involved with plans known as Multiple Employee Welfare Arrangement, or MEWAs. Although MEWAs are a specific type of plan and not all third party administrators administer MEWAs, it was in this area that the Department was presented with evidence of some harm and potential harm to consumers. For that reason, some discussion of the problems in this area is helpful in understanding the types of problems that can be caused by third party administrators.

MEWA is defined by the federal Employee Retirement Income Security Act of 1974 (ERISA). In plain language, a MEWA is a plan that combines employees of several employers into one larger pool. This pooling reduces the cost of providing insurance coverage.

ERISA's commentary on the applicability of state insurance laws on employee welfare benefit plans essentially concerned Multiple Employer Trusts (MET). It was confusing according to some state officials and led to difficulty for states. There are primarily three components of ERISA that deal with this issue.

1. ERISA states that provisions of the law supersede any and all state laws related to any employee health benefit plan.

2. ERISA then exempts state insurance regulation laws from the preemption.

3. ERISA then states neither an employee benefit plan, nor a trust established under an employee benefit plan shall be deemed to be engaged in the business of insurance for the purpose of state insurance laws.

Therefore, it can certainly be argued that ERISA effectively preempted state regulation, although the original provisions pertained to multiple employer trusts (METS). Unfortunately, the federal act provided virtually no federal regulation of these plans either. The reason for this is relatively straight forward. ERISA is administered by the Department of Labor and is primarily focused on the regulation of pension plans. In pursuit of this mission, ERISA established minimum funding amounts, benefit accrual standards, and a federal grants fund. However, the federal framework provides no such requirements to employee welfare benefit plans.

The 1982 ERISA amendments added the term MEWA to include any plan that provides the benefits of an employee benefit plan to the employees of two or more employers. The amendments went on to make technical changes that explain the extent to which states may regulate MEWAs.

The resulting regulatory void was filled by "conmen, crooks, and hucksters" according to an interim report of the U.S. Senate's Committee on Governmental Affairs dated March 12, 1992. Theoretical arguments abound as to whether or not state authorities have real authority to regulate MEWAs. Two things are unambiguous, however.

First, some consumers have been harmed by these scams. Second, many MEWAs argue that it is clear that state regulators have no authority over them. They use this position to refuse to cooperate with state officials thereby creating costly and time-consuming litigation. In the meantime, the MEWA continues to collect premiums and the plan's managers continue to collect fees and administrative payments. The problems faced in Colorado are similar to the problems that have been encountered across the nation.

If the MEWA folds, or simply refuses to pay, the insured are left facing enormous medical bills. Many of these employees of small businesses are the people who can least afford such calamity. To make matters worse, these persons believed they were insured because they had been making insurance payments. On the off-chance that these victims can find another insurance company to cover them, they will find that the condition for which the MEWA would not pay is now a "pre-existing" condition. Therefore, the insurance this person purchased is essentially bogus and they are now uninsurable.

This is usually the point at which a consumer will contact the Division of Insurance. It is also the point at which the Division first learns of the MEWAs existence.

The Colorado Division of Insurance reports that the investigation will usually result in a request for information from the MEWA. In many cases, the MEWA will assert its ERISA exemption. The Division must then pursue the MEWA for selling insurance without a license. This can involve lengthy investigations and litigation. As previously stated, the fraudulent MEWA continues to collect premiums even as the regulatory authority attempts to prove that the plan is illegal. Administrators continue to collect fees and salaries during this process.

It should be stressed that third party administrators are not limited to administering MEWAs and many TPAs operate in completely different areas. However, the MEWA example shows the type of problem that the Division may encounter with third party administrators.

III. REGULATION OF THIRD PARTY ADMINISTRATORS IN OTHER STATES

The National Association of Insurance Commissioners (NAIC) reports that approximately 25 states have either adopted the NAIC model law or have passed related legislation. Neighboring states of Arizona, New Mexico, Kansas, Utah, Texas, and Wyoming are included in the group of states imposing such regulation on third party administrators.

However, the NAIC does not track legislation once it has been implemented to assess if that legislation has been effective. Various states have been contacted regarding their experiences in implementation of third party administrator regulation. At the time of the publication of this sunrise report, no meaningful data had been provided by other states regarding discipline or other actions against third party administrators. Of course, most of these laws have been implemented only recently so there has been little opportunity to gather data.

One trend that the data appear to confirm is that regulation of third party administrators by state insurance regulators is on the increase.

IV. THE PROPOSAL FOR REGULATION

The applicants have indicted that the primary reason they are seeking regulation is to create reciprocity in other states that regulate third party administrators. The applicants propose the adoption of a model law which is attached to the sunrise application. The National Association of Insurance Commissioners' (NAIC) Third Party Administrator Model Law defines "third party administrator" as a person who directly or indirectly solicits or effects coverage of, underwrites, collects charges or premiums from, or adjusts or settles claims on residents of this state, or residents of another state from offices in this state, in connection with life or health coverage or annuities...."

The model law provides exemptions from the definition of third party administrator to some entities. Excluded are: insurers authorized to transact insurance; a union; an employer on behalf of its employees, or the employees of one or more subsidiaries or affiliated corporations of such employer, among others.

The proposed regulation for Colorado closely adheres to the National Association of Insurance Commissioners' Model Law. The highlights of this regulatory proposal follow:

License required. Any person meeting the definition of third party administrator, who is not otherwise exempt, would be required to obtain a license from the Division of Insurance.

Applicants for a license would be required to file numerous documents including: financial statements or reports for the two years preceding application; all organizational documents such as articles of incorporation; professional qualifications of the officials of the organization, board of directors and, any shareholder holding at least ten percent of the voting securities; business plan; and, proof of contract with an agent licensed by this state if the third party administrator will be managing the solicitation of new or renewal business.

Denial of a license. The Commissioner would be empowered to deny a license for a variety of reasons including incompetence or revocation or denial of a third party administrator or insurer license in another state.

Disciplinary actions against a licensee. The model law provides numerous grounds under which the Commissioner may suspend or revoke the license of a third party administrator. Important grounds include violation of the state's insurance laws or rules and regulations, refusal to cooperate with an examination or provide information requested by the Commissioner, or refusal, without just cause, to pay proper claims or cause covered individuals to accept less than the amount due them.

Insurers' responsibilities. Licensed insurers using the services of a third party administrator would be required to determine benefits, premium rates, underwriting criteria and procedures of paying claims under this proposal. The insurer would be responsible for providing this information to the third party administrator. The model act provides that insurers would bear sole responsibility for administration of its programs and, if the third party administrator administered benefits for more than one hundred certified holders on behalf of one insurer, the insurer would be required to conduct a semiannual review of the administrator. One such review would be a required on-site audit, according to the proposal.

The model act addresses a variety of other issues including requirements for written agreements between the insurer and the third party administrator, provisions regarding payment of premiums to the third party administrator by the insurer, requirements that third party administrators maintain records for at least five years, and a requirement that insurers approve advertising used by the third party administrator pertaining to the business underwriter.

Contact with the Division of Insurance and the Office of the Attorney General reveals that the model law, as presented, would not be acceptable in Colorado without some modification. The changes needed would be technical in nature and would conform the third party licensing scheme to Colorado's other statutory licensing provisions.

V. 1993 COLORADO LEGISLATION MAY ADDRESS SOME PROBLEMS

The Colorado General Assembly passed two bills in the 1993 session that directly impact the problems created by some third party administrators and MEWAs.

House Bill 1214 authorizes the Commissioner of Insurance to issue a cease and desist order if the Commissioner believes that an unauthorized person is engaging in the business of insurance in violation of Colorado law or in violation of rules promulgated by the Commissioner.

This authority could have a direct impact on the ability of the Division of Insurance to halt the operations of fraudulent MEWAs. As discussed previously, the Division must now seek to prove in litigation that the MEWA is engaging in the business of insurance in violation of Colorado law. The fraudulent MEWA can use this window of time to continue to collect premiums. HB 1214 will enable the cease and desist order to be issued based on the judgement of the Commissioner of Insurance.

House Bill 1241 directly impacts MEWAs and multiple employer health trusts. Essentially, this legislation exempts from state regulation those MEWAs which meet certain standards. Those exemption standards can be interpreted to apply to legitimate MEWAs in which the potential for fraud is greatly reduced.

For instance, to be exempt from state regulation, a MEWA must be sponsored by an association that has been in existence continuously since at least January 1, 1983, and meets certain reserve and financial reporting requirements. The MEWA must provide benefits that are in substantial compliance with state mandated benefit provisions. Such requirements will not appeal to a "fly by night" insurance "scam artist."

Similarly, a multiple employer health trust (MET), in order to meet the exemption standards, must be sponsored, maintained and funded by one or more entities of state government or state entities, or, established and maintained according to the provisions of a collective bargaining agreement between a union and employers or associations.

<u>Rules Promulgated by the Division of Insurance Concerning MEWAs</u>. The Division has promulgated Regulation 4-2-10 concerning disclosure of certain health care plans. This regulation requires that health care plans which are not fully insured, are not single employer plans, and are not Taft-Hartly Union Trust plans file certain information with the Division. Clearly, the Division will be able to amplify regulatory oversight of these plans as needed.

VI. CONCLUSION AND RECOMMENDATION

The proposal to regulate third party administrators appears to be a well-intentioned effort to deal with a potential problem. Fraud, abuse, and circumnavigation of insurance regulation can occur by third party administrators and could cause harm to policy holders.
However, Colorado has taken important steps in the 1993 legislative session to increase regulatory options of the Colorado Division of Insurance in dealing with these problems. Further, Division regulations requiring these plans to register, coupled with the legislative actions reviewed previously, may provide significant increases in the state's ability to protect the public without the creation of new bureaucracy and a burdensome licensing scheme.

Colorado's Division of Insurance appears to be moving assertively to establish the state's oversight of MEWAs, although the plans have heretofore been free to defy the orders of the Commissioner pending litigation. Regulation 4-2-10 imposes, among other requirements, a registration requirement on MEWAs. Through these reporting requirements, the Division will be aware of MEWAs operating in the state.

The Commissioner's new cease and desist authority also should greatly aid in curtailing the activities of fraudulent MEWAs. As discussed, prior to the passage of HB 1214, a fraudulent MEWA might "buy time" by claiming exemption from state regulation, thus forcing litigation to resolve whether or not the plan was illegally selling insurance. The issuance of the cease and desist order provides the Commissioner with a much quicker response mechanism although the MEWA can appeal the order to the Colorado Court of Appeals.

Similarly, HB 1241 should serve to reduce the number of fraudulent MEWAs and act as a deterrent against such plans choosing to operate in Colorado in the future. In particular, the new statutory requirement which states that only plans that have been in existence for at least ten years, meet established reserve requirements, and provide benefits in compliance with state standards in order to be exempt from direct regulation by the Division of Insurance should greatly reduce the number of "fly by night" MEWAs. HB 1241 further provides that even plans that meet the requirements for exemption are subject to statutory provisions concerning unfair methods of competition and unfair or deceptive acts or practices. Further, the plans may be subject to regulation by the Division of Insurance if the plan is hazardous to the public or to the beneficiaries of the plan. This gives the Commissioner significant latitude in dealing with these plans if they appear to be in danger of being insolvent.

As a final note, contact with the applicant indicated that a primary purpose of this proposed regulation is to establish standards and state licensing that will permit third party administrators to more easily meet requirements to practice in other states that regulate these administrators. The Department cannot recommend implementation of additional government regulation on these grounds. Third party administrators are free to meet the qualifications for practice of any state in which they wish to provide their services.

The Department of Regulatory Agencies believes that licensing of third party administrators is premature in light of 1993 legislation that addresses the very problems that have occurred. In making this recommendation not to impose new licensing requirements, the Department is persuaded by the evidence that almost all significant problems have been encountered by third party administrators in one particular area.

However, licensing TPAs should remain an option if harm to consumers occurs in the future by third party administrators. In the meantime, Colorado's new legislation should be given an opportunity to work in those areas where there is demonstrated harm before additional legislative steps are taken.