

ADVERSE UNDERWRITING DECISION DILEMMA IN VIRGINIA

Ben R. Lacy, IV, Esq.
(804) 783-6773

History

The Virginia Insurance Information and Privacy Protection Act (the “Virginia Act”) was passed by the Virginia General Assembly during the 1981 Session and took effect on January 1, 1982. It generally duplicated the Adverse Underwriting Decision Law found in the old Unfair Trade Practice Act but is now a separate chapter and section in 17 states and is modeled on the NAIC Insurance Information Privacy Protection Model Act (the “Model Act”), as revised in December, 1980.¹

The purpose of the Virginia Act is to strike a reasonable balance between (1) the legitimate needs of the insurance industry for information, and (2) the public’s need for fairness in insurance information practices and protection of personal privacy. Further, it established standards for the collection, use and disclosure by insurers, agents and insurance-support organizations of personal information gathered in connection with an insurance transaction. It also established a regulatory mechanism which enables individuals to ascertain what personal information is being or has been collected about them and to have access to such information for the purpose of verifying or disputing its accuracy. Finally, it limited the disclosure of information about individuals and enables them to obtain the reasons for any adverse underwriting decision.²

In Virginia, then Commissioner of Insurance, James W. Newman, Jr., was instrumental in pushing the Model Act to the 17 states that have now enacted these provisions. In most states that have enacted this Model Act, it applies to the underwriting and servicing of insurance purchased primarily for personal, family or household needs rather than business or professional needs.³ The scope of these acts is *not* identical with the industry’s common classification of personal lines and commercial lines of insurance.

The Problem in Virginia

Most of the states define an adverse underwriting decision (“AUD”) as a declination or termination of insurance coverage or a failure of the agent to apply for insurance coverage with a specific institution that an agent represents and that is requested by the applicant (the statutes then have provisions with regard to property and casualty insurance). More importantly, there is often a provision that defines an AUD as an offer to insure at a “higher than standard rate.” Sometimes it is confined (N.C.)⁴ to life, accident, or health insurance, or includes life, health, or disability insurance coverage.⁵ In Virginia, it also includes the language that gives rise to one of the two major issues in the Commonwealth, the statutory language where a policy is issued “*with limitations, exceptions, or benefits other than those applied for.*”⁶

Annually, we receive approximately eight inquiries from non-domestic carriers where they have been subjected to target market examinations, complaints, etc. involved with AUD violations. The following are two or more reoccurring situations:

1. **Declination Definition.** This generally occurs when an applicant has applied for life insurance or has requested, on his renewal anniversary, additional coverage and the requisite medical information is required. The underwriting department of our carriers send out the requested information to the medical providers and no information is forthcoming. Both the agent and the applicant are informed of this request and are also informed of the absence of a response of information from the medical provider. Generally, another request is made and no information is provided by the applicant’s doctor. Our insurance clients generally put this particular file in a “suspense” category, the agent pursues other applicants and the applicant simply goes on with his normal day-to-day living. Sometimes the applicant dies and the surviving spouse files a complaint wondering why the life insurance was never issued. On other occasions, there is a target market conduct examination being conducted on this particular carrier and some of these “suspended” files are examined. At that point, the problems surfaces and gets the attention of the Virginia Bureau of Insurance (“VABOI”).
2. **Statutory Language Problem.** Virginia is unique in that its Act has language that says that an AUD notice should be sent in the case of a life or accident and sickness insurance coverage where an offer to insure is at higher than standard rates “or with limitations, exceptions or benefits other than those applied for.” Quite often, in the case of a new applicant or sometimes with a renewal applicant, limitations, exceptions or benefits are either requested by the applicant or provided, unilaterally, by our carrier clients. In those instances, in Virginia, an AUD notice is required.

In Virginia, this knife cuts both ways. Sometimes, the life insurance or health insurance coverage will have limitations or exceptions which the applicant would normally not expect and the requisite AUD notice *should be sent*. In other

situations, the carrier will offer “benefits” that the applicant did not apply for or anticipate would be available to him. In these instances, VABOI has required AUD notices and has often penalized the carrier if no AUD notice is sent. Again, the AUD *should be sent*.

Virginia Insurance Analysis

Regarding the first scenario, the VABOI takes the position that if no *absolute* decision has been made with regard to declining or terminating insurance coverage *for whatever reason*, including the failure to obtain the appropriate medical information, and the application is then not processed or granted, it is a “declination” under our Code and would require an AUD notice to be sent to the applicant.

Unfortunately, it appears that most of our carrier clients, when corresponding to VABOI, indicate that they have a general business practice placing such applications in the “suspense” category. Generally, the VABOI responds that this is merely a postponement of the continued underwriting of the application until requested medical information is received. Since the inception of this Virginia Act, it has been the position of VABOI that once an application is submitted, whether to the agent or to the insurer, if the policy is not issued, an AUD has occurred and the insurer is obligated to comply with the adverse underwriting decision requirements as set forth in Section 38.2-610 of the Code of Virginia. The insurer’s determination that coverage would not be issued, while it may have been for perfectly valid reasons, such as the failure of the attending physician to submit a medical report, is nevertheless a declination of insurance coverage and therefore an adverse underwriting decision and subject to the requirements of Section 38.2-610, Code of Virginia.

Most carriers justify such situations on the grounds that the law does not appear to allow the insurer to make the assumption that the additional information may be obtained, which would then give the insurer an opportunity to pursue a formal AUD. Further, the insurers generally acknowledge that the case has been “discontinued” and the VABOI takes the position that a decision has been made, albeit a decision that the insurer quite properly made under the circumstances. Finally, the VABOI justifies its position by stating that a decision adverse to the applicant (i.e., refusal to issue the policy) was made, and the insurers were required to so inform the applicant.

VABOI analysis with regard to the second situation is basically the same as that in the first but always applies to the issuance of a policy which contains limitations, exceptions or *benefits* other than those applied for. Again, once an application is submitted, whether to the agent or the insurer, and if the policy is ultimately issued which contains such limitations, exceptions, or *benefits* other than those applied for, then an AUD notice is required.

To further compound the issue in Virginia, our insured clients often justify the underwriting decision to make limitations, establish exceptions or *even provide benefits* other than those applied for by stating that it is a “general business practice” of the insurer to handle such situations by not sending AUD notices.

Penalties

Generally, the VABOI in responding to our carrier clients will suggest to an insurer that this provides an opportunity for the VABOI to review all of its records since the inception of the Virginia Law (1981) either on its own or by a review of a team of market conduct examiners from their office. Because our insurer clients have often stated that they handle these matters as a general business practice, the VABOI is confident that such a review would uncover hundreds, if not thousands, of violations.

Pursuant to Sections 38.2-218 and 38.2-1040 the Code of Virginia, violations of Section 38.2-610 could subject the insurer to monetary penalties of up to \$5,000 for each violation as well as suspension or revocation of the insurer’s license to do business in Virginia.⁷ Most, if not all of the information and privacy protection statutes enacted by the 17 states also have individual remedies where the individual (applicant) may bring an action in a court of competent jurisdiction that could award the cost of the action, reasonable attorneys’ fees and appropriate equitable relief. Of course, there is generally a two-year statute of limitations on such actions.⁸

Also in Virginia, the threat of a cease and desist order and the subsequent nationwide reporting of such an order generally gets the attention of our carrier clients. The VABOI has consistently assessed a penalty *no less than \$15,000 for even one occurrence* with the cease and desist order being discussed, and hopefully eliminated, but a settlement order being entered.

Solution

The most effective manner in which to handle these situations is for each carrier to adopt a procedure for adverse underwriting letters/notices. The first would be for rated or declined cases and it would be important for a letter to be sent to the applicant with the reason for the increased rate or declination. The states that *strictly* require these notices are Arizona, California, Georgia, Illinois, North Carolina, Virginia and Washington.⁹ The agent is copied with an

advance notice of this letter, the declination files are held in suspense for 10 days, at which time they should be pulled and the original letters mailed to the applicant and the file declined on the system. For rated cases, personnel should place a copy of the letter in the file and route the file to the particular area to be issued. A copy of the letter is mailed out with the policy to the agent, and the original letter to the applicant is held for 10 days in suspense and then mailed to the client. As an aside, if the file is being rated or declined due to information from a consumer reporting agency, personnel should type in an additional paragraph giving the applicant the name and address of a consumer reporting agency providing the information from which the decision was based. The AUD notice should accompany each letter.

With regard to procedures for discontinued/withdrawn cases, the following procedures should be adopted:

1. The underwriters should mark the file discontinued and give the reason, such as lack of ABS, blood, urine, complete application, or failure to submit to exam, etc. The case then should be routed to personnel to process the discontinued correspondence.
2. Personnel should send a letter to the client, with a copy to agent, stating the reason it is being discontinued. The agent should get a 10-day advance notice of the discontinuance, but the letter to the applicant should be sent and an *AUD notice* provided with that letter.

Please remember that the language contained in the AUD notice can be as consumer friendly as the insurer desires. In most cases, the applicant (1) is the subject of an adverse underwriting decision; (2) has the right to obtain in writing the specific reason(s) for the adverse decision upon written requests; (3) is entitled to know the specific items of information supporting the reasons and the sources of that information; and (4) reviews the documents relating to the action taken and, upon payment of reasonable reproduction charge, obtains copies of those documents.

Conclusion

Virginia strictly enforces the statutory requirements of Sections 38.2-602 and 38.2-610. The rather large penalty does not go to the Bureau of Insurance or the State Corporation Commission, but, to The Literary Foundation of the Commonwealth of Virginia. The amount certainly gets the attention of our carrier clients.

Endnotes

1. Arizona – Ariz. Rev. Stat. Ann. §§ 20-2101 to 20-2120 (1981).
California – Cal. Ins. Code §§ 791.01 to 791.26 (1981/1989).
Connecticut – Conn. Gen. Stat. §§ 38a-975 to 38a-998 (1981/1983).
Georgia – Ga. Code Ann. §§ 33-39-1 to 33-39-23 (1982/1985).
Hawaii – Hawaii Rev. Stat. §§ 431:17-101 to 431:17-106 (1988).
Illinois – 215 Ill. Comp. Stats. 5/1001 to 5/1024 (1981/1982).
Kansas – Kan. Stat. Ann. §§ 40-2,111 to 40-2,113 (1981/1986) (Part of model).
Massachusetts – Mass. Gen. Laws ch 175I §§ 1 to 22 (1992).
Minnesota – Minn. Stat. §§ 72A.49 to 72A.505 (1989).
Montana – Mont. Code Ann. §§ 33-19-101 to 33-19-409 (1982).
Nevada – Nev. Admin. Code §§ 679B.560 to 679B.750 (1989/1997).
New Jersey – N.J. Rev. Stat. §§ 17:23A-1 to 17:23A-22 (1985).
North Carolina – N.C. Gen. Stat. §§ 58-39-1 to 58-39-120 (1981).
Ohio – Ohio Rev. Code Ann. §§ 3904.1 to 3904.22 (1994).
Oregon – Or. Rev. Stat. §§ 746.600 to 746.690 (1981/1988).
Virginia – Va. Code §§ 38.2-600 to 38.2-620 (1986/1987).
Wyoming – Wyo. Ins. Regs. ch 25 (1989).
2. Virginia Administrative Letter 1981-4.
3. *Ibid.*, see No. 1.
4. N.C. Gen. State § 58-39-15 (1981).
5. Ohio Rev. Code Ann. §§ 3904.01 (1981).
6. Va. Code § 38.2-602 i.e. (1950, as amended, 1981).
7. Va. Code §§ 38.2-218, 38.2-1040, 38.2-610 (1950, as amended, 1981).
8. *Ibid.*, see No. 1.

9. *Ibid.*, see No. 1.