

**UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

NO. 07-2165

EDSTROM INDUSTRIES, INCORPORATED,

Plaintiff-Appellant,

v.

**COMPANION LIFE INSURANCE COMPANY,
INCORPORATED**

Defendant-Appellee.

**ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN,
CASE NO. 06-C-964**

Aaron C. Goodstein, Magistrate Judge

**NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS'
BRIEF OF *AMICUS CURIAE* IN SUPPORT OF APPELLANTS AND
SUPPORTING REVERSAL OF THE JUDGMENT BELOW**

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TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES.....	i
I. IDENTITY AND INTEREST OF AMICUS CURIAE.....	1
A. IDENTITY OF AMICUS CURIAE.....	1
B. INTEREST OF AMICUS CURIAE.....	2
II. STATEMENT OF THE CASE.....	3
III. SUMMARY OF ARGUMENT.....	4
IV. ARGUMENT.....	5
A. State Regulation of Stop Loss Insurance.....	5
B. State Regulation of Multiple Employer Welfare Arrangements and Unauthorized Health Plans.....	9
C. Policyholder Standing in Liquidation and Guaranty Fund Coverage.....	12
D. Assessment of Stop Loss Insurance to Fund State High Risk Health Pools.....	13
E. State Regulation of Reinsurance.....	15
V. CONCLUSION.....	17

TABLE OF AUTHORITIES

	<u>Page</u>
<u>Cases</u>	
<i>Avemco Ins. Co. v. State ex rel. McCarty</i> , 812 N.E.2d 108 (Ind. Ct. App. 2004)	15
<i>BCBSM, Inc. v. Minnesota Comprehensive Health Ass'c</i> , 713 N.W.2d 41 (Minn. Ct. App. 2006).....	15
<i>Kentucky Ass'n of Health Plans v. Miller</i> , 538 U.S. 329 (2003).....	6
<i>Metropolitan Life Ins. Co. v. Mass.</i> , 471 U.S. 724 (1985)	6
<i>SAFECO Life Insurance Co. v. Musser</i> , 65 F.3d 647 (7th Cir. 1995).....	14
<u>Federal Statutes</u>	
15 U.S.C. § 1011, <i>et seq.</i>	2
29 U.S.C. § 1001, <i>et seq.</i>	5
29 U.S.C. § 1144.....	6,10
<u>State Statutes</u>	
COLO. REV. STAT. § 10-16-119	8
N.J. STAT. ANN. § 17B:27A-17	8
Wis. Admin. Code Ins. § 52.01, <i>et seq.</i>	16
Wis. Stat. Chpt. 149, <i>et seq.</i>	14
Wis. Stat. § 149.13(3)(a)	14
Wis. Stat. § 631.01	4,17

Wis. Stat. § 646.01 12,13

Wis. Stat. § 645.68 12

NAIC Model Laws

Credit for Reinsurance Model Law, 5 NAIC *Model Laws, Regulations and Guidelines*, 785-1 to 785-8 (1984)..... 16

Credit for Reinsurance Model Regulation, 5 NAIC *Model Laws, Regulations and Guidelines*, 786-1 to 786-22 (1991).....16

Insurer Receivership Model Act, 3 NAIC *Model Laws, Regulations and Guidelines*, 555-1 to 555-96 (2005).....12

Prevention of Illegal Multiple Employer Welfare Arrangements (MEWAs) and Other Illegal Health Insurers Model Regulation, 2 NAIC *Model Laws, Regulations and Guidelines*, 220-1 to 220-18 (2006, amended 2007).....9

Stop Loss Insurance Model Act, 1 NAIC *Model Laws, Regulations and Guidelines*, 92-1 to 92-2 (1995).....7

NAIC White Papers and Bulletins

ERISA: BARRIER TO HEALTH CARE CONSUMERS' RIGHTS, 3 Proc. of the Nat'l Ass'n of Ins. Comm'rs 841 (1999).....6

U.S. REINSURANCE COLLATERAL WHITE PAPER, 1 Proc. of the Nat'l Ass'n of Ins. Comm'rs 110 (2006).....16

NAIC Model Bulletin, REGULATORY ALERT TO STOP LOSS CARRIERS AND THIRD PARTY ADMINISTRATORS, 2 Proc. Of the Nat'l Ass'n of Ins. Comm'rs 232 (2003).....11

Other Authorities

Conn. Op. Att'y Gen., April 15, 2005.....16

Kenneth Thompson, REINSURANCE (4th ed. 1966)..... 6

Martin Tolchin, *More Companies Choosing to Self-Insure Benefits*, N.Y. TIMES, August 3, 1990.....7

Me. Ins. Bulletin, *Excess Loss Insurance*, ME Bulletin No. 222 (October 4, 1993) 8

North Carolina Institute of Medicine et al., Fact Sheet, *Covering the Uninsured*, (April 2006).....13,14

OCI Bulletin, June 4, 2003, REGULATORY ALERT TO STOP LOSS CARRIERS AND THIRD PARTY ADMINISTRATORS..... 11

Pat Butler, *ERISA Complicates State Efforts to Improve Access to Individual Insurance for the Medical High Risk*, State Coverage Initiatives Issue Brief (August 2000).....15

Russell Korobkin, *The Battle Over Self-Insured Health Plans, or “One Good Loophole Deserves Another”*, 5 Yale J. Health Pol’y, L. & Ethics 89, 118 (2005)..... 7

Tenn. Ins. Bulletin, *Regulation of Excess Stop-loss Coverage*, TN Bulletin 7-1-94 (1994).....8

Terry Humo, Thompson Publishing Group, Employer’s Guide to Self-Insuring Health Benefits, (2007).....5,7

U.S. Gen. Accounting Office, PRIVATE HEALTH INSURANCE: EMPLOYERS AND INDIVIDUALS ARE VULNERABLE TO UNAUTHORIZED OR BOGUS ENTITIES SELLING COVERAGE, GAO-04-312, (2004) 10

U.S. Gen. Accounting Office, STATE REINSURANCE OVERSIGHT INCREASED, BUT PROBLEMS REMAIN, GGD-90-82, (1990)..... 16

I. IDENTITY AND INTEREST OF *AMICUS CURIAE*

A. IDENTITY OF *AMICUS CURIAE*

Amicus curiae, National Association of Insurance Commissioners (“NAIC”), is a not-for-profit Delaware corporation whose membership consists of the chief insurance regulatory officials of each state, the territories and insular possessions of the United States and the District of Columbia. Created in 1871, the NAIC is the nation’s oldest association of state government officials.

The NAIC’s purpose is to provide its members with a national forum enabling them to work cooperatively on regulatory matters that transcend the boundaries of their own jurisdictions. Collectively, the state insurance commissioners work to develop model legislation, rules, regulations, white papers and actuarial guidelines that promote and establish uniform regulatory policy. Their overriding objectives are to protect consumers as well as assist in maintaining the financial stability of the insurance industry.

The NAIC performs numerous crucial services on behalf of state governments including: developing and publishing model laws, regulations, bulletins, financial and accounting standards, white papers, consumer guides, handbooks, periodicals and the *Proceedings of the NAIC*. Hundreds of state and federal laws assign duties to the NAIC and incorporate NAIC

standards, models and other publications. In addition, the NAIC manages and coordinates the accreditation review of insurance departments as well as maintains regulatory and financial databases of insurance company financial data.

Any member of the NAIC may request the filing of an *amicus curiae* brief. All such requests require approval by the NAIC's Executive Committee. At the request of NAIC member and fellow *amicus curiae*, State of Wisconsin, Office of the Commissioner of Insurance ("Wisconsin Insurance Commissioner"), the NAIC Executive Committee has approved the filing of this *amicus* brief.

B. INTEREST OF *AMICUS CURIAE*

The interest of the NAIC in this case arises out of the regulatory responsibility vested in each commissioner over stop loss insurance offered in their state. The insurance commissioners of the various states are charged by state and federal law with the responsibility of regulating the business of insurance within his or her jurisdiction pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*, and state insurance laws.

This case addresses the issue of whether a stop loss insurance policy covering an employer's self-insured employee health benefit plan ("stop loss insurance") is insurance or reinsurance for purposes of regulation under

Wisconsin insurance statutes. Insurers choosing to conduct business in a state must, in most situations, possess a certificate of authority prior to engaging in any insurance activities. By receipt of this authority, the insurer agrees to abide by the state's laws and regulatory scheme, which are designed to protect consumers and employers purchasing stop loss insurance for their self-funded health plans. Thus, the outcome of this decision will affect the longstanding state regulatory approach for the oversight of stop loss insurance and reinsurance.

The NAIC is in agreement and fully supports the brief of the Wisconsin Insurance Commissioner and its legal arguments with respect to the regulation of stop loss insurance in Wisconsin. Although such arguments are summarized herein, we additionally offer the national and public policy perspectives of our association and NAIC member states.

II. STATEMENT OF THE CASE

The NAIC adopts the statement as set forth by Plaintiff-Appellant Edstrom Industries, Incorporated.

III. SUMMARY OF ARGUMENT

The District Court erred in holding that the stop loss insurance policy was a form of reinsurance as used in Wis. Stat. § 631.01(2), and finding that, as such, it was excluded from regulation under Wisconsin insurance statutes. The District Court's decision to treat stop loss insurance as reinsurance raises several issues that are of general and national concern to the membership of the NAIC:

1. The continued ability to regulate stop loss insurance under state insurance statutes for the protection of consumers and employers.
2. The prevention of unlicensed (i.e., illegal) health insurance plans, including certain fraudulent schemes involving the use of stop loss insurance by unlicensed Multiple Employer Welfare Arrangements.
3. The continued priority of stop loss insurance policyholders in insurance company liquidations and guarantee fund coverage.
4. The continued authority to assess stop loss insurance carriers to fund state high risk health pools.
5. The state regulatory scheme governing reinsurance as it applies to licensed insurance companies.

IV. ARGUMENT

A. State Regulation of Stop Loss Insurance

The District Court's decision holding that the stop loss insurance policy was a form of reinsurance, and excluding it from regulation under Wisconsin insurance statutes, was clearly erroneous. To those outside the insurance regulatory arena, it might not make much difference whether stop loss is considered insurance or reinsurance. However, state insurance codes typically apply to insurance, but not directly to reinsurance. This is because reinsurance is a contract between two insurance companies, each of which is regulated under the state insurance code:

Although some stop loss providers use the terms interchangeably, stop loss insurance differs from reinsurance in that only insurance companies "in the business of insurance," licensed and regulated by a state insurance department, are supposed to be able to purchase a reinsurance treaty or contract. A reinsurance treaty purchased by an individual employer's plan may be deemed to be a primary insurance policy and may be subject to premium taxes.

Terry Humo, Thompson Publishing Group, *EMPLOYER'S GUIDE TO SELF-INSURING HEALTH BENEFITS*, ¶ 600 (2007), at 2.

It is important to understand the historical context of state regulation of stop loss insurance. Prior to the passage of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001, *et seq.*, states and state insurance commissioners retained the primary responsibility for

regulating health insurance. ERISA: BARRIER TO HEALTH CARE CONSUMERS' RIGHTS, 3 Proc. of the Nat'l Ass'n of Ins. Comm'rs (1999), at 841. ERISA introduced the concept that self-insured plans would be regulated differently than fully insured plans under state insurance laws. 29 U.S.C. § 1144(b)(2)(B); *Metropolitan Life Ins. Co. v. Mass.*, 471 U.S. 724, 747 (1985). However, even prior to the enactment of ERISA, it was recognized that stop loss insurance issued to a self-funded plan of any type was considered to be insurance, and not reinsurance:

Sometimes the word "reinsurance" is used in connection with problems of "self-insurance", where the self-insurer takes care of its obligations up to a certain point but depends upon some form of "reinsurance" or "excess" insurance for its shock or catastrophic losses (compare "Stop Loss' Policies"). As an example of the added use of the word "reinsurance" compare the Workmen's Compensation law of Massachusetts which states that every self-insurer shall make arrangements 'by reinsurance' to protect against extraordinary loss....The self-insurer for economic stability and soundness will obtain coverage which some may call 'reinsurance' but which is really of a type of "specific" excess insurance.

Kenneth Thompson, REINSURANCE, 7-8 (4th ed. 1966).

ERISA preempts direct state regulation of single-employer sponsored health plans, but ERISA does not preempt state laws that regulate insurers that sell policies to employer plans, so long as the law is specifically directed at the insurance industry and it regulates insurance practices. *Kentucky Ass'n of Health Plans v. Miller*, 538 U.S. 329, 334 (2003). The states cannot

regulate an employer's self-insured health plan, but states may still regulate stop loss insurance policies. Terry Humo, Thompson Publishing Group, *EMPLOYER'S GUIDE TO SELF-INSURING HEALTH BENEFITS*, ¶ 743 (2007), at 53. Since the passage of ERISA, there has been a marked increase in the use of self-funded health benefit plans by employers, many of which are small and medium-sized businesses, and a corresponding increase in the issuance of stop loss insurance. Martin Tolchin, *More Companies Choosing to Self-Insure Benefits*, N.Y. TIMES, August 3, 1990.

To respond to growing perceived abuses in the stop loss insurance industry, state regulators, through the NAIC, adopted the Stop Loss Insurance Model Act, 1 NAIC *Model Laws, Regulations and Guidelines*, 92-1 to 92-2 (1995). The Model Act was intended to prevent insurers selling stop loss insurance from circumventing state health insurance requirements protecting employers and consumers, such as the right to guaranteed renewal and restrictions on rate increases. For a discussion of the policy issues associated with this Model Act, see Russell Korobkin, *The Battle Over Self-Insured Health Plans, or "One Good Loophole Deserves Another"*, 5 Yale J. Health Pol'y, L. & Ethics 89, 118 (2005).

NAIC model laws and regulations are representative of the laws of the NAIC member states. Individual states may have or will adopt or issue the Model Act. In addition to expressing their views by virtue of participation in the NAIC (and authorizing this *amicus* brief), NAIC member states have adopted or issued a variety of statutes, regulations and/or bulletins reflecting that their insurance codes directly regulate stop loss coverage as insurance. For example, in Tennessee, stop loss insurance must be written by licensed insurers and stop loss coverage is not considered to be “reinsurance.” Tenn. Ins. Bulletin, *Regulation of Excess Stop-loss Coverage*, TN Bulletin 7-1-94 (1994). In New Jersey, stop loss coverage is defined as a policy where employees or other individuals are not third party beneficiaries under the policy. N.J. STAT. ANN. § 17B:27A-17 (West 2007). In Maine, employers using stop loss coverage must comply with the law on continuation of coverage. Me. Ins. Bulletin, *Excess Loss Insurance*, ME Bulletin No. 222 (October 4, 1993). In Colorado, stop loss policies must be issued to insure the employer and not the employees, and payments must be made to the employer and not the employees. COLO. REV. STAT. § 10-16-119 (West 2002).

Stop loss insurance issued to self-insured employer health plans occupies a unique position within the scheme of regulation by the states.

While the self-insured plans themselves are not directly regulated by the states under ERISA, stop loss insurance issued to these plans is still fully subject to state regulation. The states, in coordination with the NAIC, have taken an active role in the regulation of stop loss insurance, which could be negatively impacted if the District Court's decision is permitted to stand, greatly reducing the protections provided to consumers and self-insured businesses.

B. State Regulation of Multiple Employer Welfare Arrangements and Unauthorized Health Plans

Consumer protection is the NAIC's highest priority. In order to better protect employers and consumers, state regulators through the NAIC adopted the Prevention of Illegal Multiple Employer Welfare Arrangements (MEWAs) and Other Illegal Health Insurers Model Regulation, 2 NAIC *Model Laws, Regulations and Guidelines*, 220-1 to 220-18 (2006, amended 2007). The Model Regulation specifically provides under § 2(O)(1) that "stop loss policy coverage...is insurance, not reinsurance," while § 4(D)(1) of the Model Regulation specifically requires stop loss insurance carriers to carry out due diligence in order to confirm that a health benefit plan does not constitute a multiple employer welfare arrangement ("MEWA") or other unauthorized health insurance.

The NAIC recommended the Model Regulation for adoption under their state insurance codes as a means to prevent the operation of fraudulent unlicensed health insurers. The Model Regulation reflects that the member state insurance codes govern insurance, including stop loss insurance, but typically do not directly apply to reinsurance. Under ERISA, states have the primary responsibility to regulate the fiscal soundness of MEWAs and to license their operators. 29 U.S.C. § 1002(40); 29 U.S.C. § 1144(b)(6)(A). MEWAs generally are plans or other arrangements that provide health and welfare benefits to the employees of two or more employers, and as such resemble unlicensed group insurance carriers.

The United States General Accounting Office (“GAO”) issued a report on the regulation of MEWAs. U.S. GEN ACCOUNTING OFFICE, PRIVATE HEALTH INSURANCE: EMPLOYERS AND INDIVIDUALS ARE VULNERABLE TO UNAUTHORIZED OR BOGUS ENTITIES SELLING COVERAGE, GAO-04-312 (2004). In this report, the GAO identified 144 entities not authorized to sell health benefits coverage from 2000 through 2002. These unauthorized entities covered at least 15,000 employers and more than 200,000 policyholders, and left at least \$252 million in unpaid medical claims. Many of these entities took the form of self-funded employer health plans backed by stop loss insurance, but were later determined to be

unauthorized MEWAs subject to state regulation. The Model Regulation is applicable to insurers issuing stop loss insurance precisely because that product is insurance, not reinsurance. It requires an insurer in the business of issuing stop loss insurance policies to engage in due diligence to determine that the policyholder is not a fraudulent health insurance scheme, a MEWA.

In June 2003, the NAIC also issued Model Bulletin, REGULATORY ALERT TO STOP LOSS CARRIERS AND THIRD PARTY ADMINISTRATORS, 2 Proc. Of the Nat'l Ass'n of Ins. Comm'rs 232, 234 (2003). The Model Bulletin specifically noted that "Stop loss coverage is insurance, not 'reinsurance'..." The Wisconsin Insurance Commissioner issued this Bulletin on June 4, 2003. *See* OCI BULLETIN, JUNE 4, 2003 REGULATORY ALERT TO STOP LOSS CARRIERS AND THIRD PARTY ADMINISTRATORS. The Model Bulletin was recommended to the member states to be mailed to their licensed insurers. The Model Bulletin emphasized the key role that licensed insurers play in state efforts to combat fraudulent health insurance entities. It reminded stop loss insurers that, as part of their commitment to good business practices, and because of state insurance code provisions addressing unauthorized insurance, they are obligated to maintain internal controls and business

practices to ensure they did not become unwitting accomplices of illegal health insurance plans.

C. Policyholder Standing in Liquidation and Guaranty Fund Coverage

In addition to the direct regulation of stop loss insurance, the NAIC has adopted model laws to establish protections that are significantly dependent on the treatment of stop loss coverage as insurance, and not reinsurance. This is particularly true with respect to state law giving insurance policyholders priority over reinsurance claimants in insolvency proceedings, and state guarantee fund coverage of claims under stop loss insurance issued by an insolvent insurer. § 801(C)(1) of the Insurer Receivership Model Act, 3 NAIC *Model Laws, Regulations and Guidelines*, 555-1 to 555-96 (2005), provides that obligations of the insolvent insurer arising out of reinsurance contracts have a lower priority than do claims under policies of insurance. Wisconsin law includes a corresponding provision, Wis. Stat. § 645.68.

In addition, Wis. Stat. § 646.01(1)(a)1 provides that guaranty fund coverage only applies to lines of direct insurance, which precludes guaranty fund coverage for reinsurance agreements. The Wisconsin Insurance Security Fund, a non-profit legal entity created by the Wisconsin legislature to protect Wisconsin resident policyholders in the event of an insolvency of

a member insurance company, provides coverage for stop loss insurance. Wis. Stat. § 646.01(1)(b)9. The Attorney General of the State of Connecticut also specifically found that stop loss insurance was covered under the Connecticut Life and Health Insurance Guaranty Association Act. Conn. Op. Att’y Gen. April 15, 2005.

Insurance regulation in the United States is oriented toward protecting consumers who lack the resources to evaluate the financial condition of insurers and the sophistication to compare insurance products. This is reflected in the receivership laws and guaranty association laws, which have been adopted by all the NAIC members and the various states. Priority of distribution provisions in receivership laws have been structured to give a high priority to stop loss policyholders while placing reinsurance agreements at a lower, general creditor level. For these reasons, the regulation of stop loss as insurance is of great importance to the NAIC and the consumers which its state member insurance departments protect.

D. Assessment of Stop Loss Insurance to Fund State High Risk Health Pools

Thirty-three states have established high risk pools to help spread the costs of providing insurance to people with significant health problems. North Carolina Institute of Medicine et al, Fact Sheet, *Covering the Uninsured* (April 2006). A significant number of people have difficulty

obtaining insurance due to their generally poor health status, and are often referred to as medically uninsurable. The medically uninsured are a large and ever growing problem in America, and high risk pools are a major mechanism used by states to help provide health insurance for this uninsured population. The costs of high risk pools routinely exceed the premiums paid by subscribers. Twenty-seven states use an assessment on health insurers (including stop loss carriers) to help fund the losses in the high risk pool. North Carolina Institute of Medicine et al, Fact Sheet, *Covering the Uninsured* (April 2006).

Wisconsin's Health Insurance Risk-Sharing Plan ("HIRSP") is representative of these state-run pools for medically uninsurable persons, and it began operations in 1981. Wis. Stat. Chpt. 149, *et seq.* In order to help fund their share of the HIRSP, each Wisconsin health insurer, including stop loss carriers, is assessed an amount based on the individual insurer's market share of Wisconsin health insurance business measured by the volume of premiums sold in the state. Wis. Stat. § 149.13(3)(a). The Seventh Circuit Court of Appeals in *SAFECO Life Insurance Co. v. Musser*, 65 F.3d 647, 653 (7th Cir. 1995), has held that Wisconsin's assessments on stop loss insurance sold to self-funded employee welfare benefit plans under HIRSP is not preempted by ERISA. Other courts addressing this issue have

reached the same conclusion. Pat Butler, *ERISA Complicates State Efforts to Improve Access to Individual Insurance for the Medically High Risk*, State Coverage Initiatives Issue Brief (August 2000), at 3; *Avemco Ins. Co. v. State ex rel. McCarty*, 812 N.E. 2d 108 (Ind. Ct. App. 2004); *BCBSM, Inc. v. Minnesota Comprehensive Health Ass'c*, 713 N.W. 2d 41 (Minn. Ct. App. 2006).

No stop loss insurer has seriously contended that it is exempt from participating in the maintenance of the Wisconsin pool for the medically uninsurable because it issues “reinsurance” rather than insurance. However, if the District Court’s decision that the stop loss insurance policy is reinsurance is allowed to stand, it may have the unintended effect of precluding Wisconsin and other states from assessing stop loss carriers to fund state high risk health pools for the medically uninsurable.

E. State Regulation of Reinsurance

Unlike insurance policies, reinsurance contracts and rates are to a large extent not directly regulated by the states. As earlier stated, this is because reinsurance is a contract between two regulated insurance companies, both of which understand the insurance mechanism and insurance contracts. The regulatory approach to reinsurance in the United States has traditionally been focused on the ceding (primary) company's

reinsurance arrangements and the specific provisions in its reinsurance agreements. U.S. Reinsurance Collateral White Paper, 1 Proc. Of the Nat'l Ass'n of Ins. Comm'rs 110, 119- 120 (2006).

Since 1984, the states (working through the NAIC) have proposed model legislation to improve uniformity in reinsurance regulation and have required an increasing amount of information about reinsurance arrangements from both primary insurers and reinsurers. U.S. GEN. ACCOUNTING OFFICE, STATE REINSURANCE OVERSIGHT INCREASED, BUT PROBLEMS REMAIN, GGD-90-82 (1990), at 26. The Credit for Reinsurance Model Law, 5 NAIC *Model Laws, Regulations and Guidelines*, 785-1 to 785-8 (1984) and the Credit for Reinsurance Model Regulation, 5 NAIC *Model Laws, Regulations and Guidelines*, 786-1 to 786-22 (1991), have been adopted in some form by every jurisdiction in the United States (including Wisconsin under Wis. Admin. Code Ins. §§ 52.01 to 52.07).

The reinsurance regulatory scheme recommended by the NAIC and enacted by the states reflects that reinsurance is a contract for risk transference between two insurance companies. This regulatory scheme is not designed to protect, and does not contemplate any protections appropriate for, employers that purchase stop loss insurance coverage.

Rather, the protections for stop loss insurance are provided by direct regulation of the insurance companies writing stop loss coverage.

V. CONCLUSION

The District Court erred in holding that the stop loss insurance policy was a form of reinsurance as used in Wis. Stat. § 631.01(2), and finding that, as such, it was excluded from regulation under Wisconsin insurance statutes. The NAIC reflects a consensus among its member states that stop loss coverage is insurance, and not reinsurance.

The protections for consumers and employers enacted by the states depend upon the treatment of stop loss coverage as insurance. These protections include a model regulation on MEWAs, which is designed to prevent schemes to defraud employers and individuals by offering unauthorized and fraudulent health care coverage. They also include state insurance receivership laws that give stop loss policyholders priority over reinsurance agreements in insurance company insolvencies, and state models like Wisconsin's Insurance Security Fund that provide guaranty fund coverage for claims against insolvent insurance companies for stop loss policyholders, but not with respect to reinsurance agreements. They also include funding mechanisms for state health insurance pools for the medically uninsurable. State regulation of reinsurance contracts applies to,

and is intended to regulate, only contracts between licensed insurance companies, and not insurance policies issued by a stop loss carrier to an employer self-funded health plan.

For all the above reasons, the NAIC respectfully urges the Court to reverse the decision of the District Court.

Respectfully Submitted,

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CERTIFICATION

I certify that this brief conforms to the rules contained in Fed. R. App. P. 32(a)(5), (6) and 7(B) for a brief produced using the following font:

Proportional spaced type: 14 point body text and 14 point for quotes. The length of the brief is 4,063 words.

Dated this 16th day of August, 2007.

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CERTIFICATE OF SERVICE

Noreen J. Parrett hereby certifies that on the 17th day of August, 1007, true and correct copies of MOTION OF NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT and NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS' BRIEF OF *AMICUS CURIAE* IN SUPPORT OF APPELLANTS AND SUPPORTING REVERSAL OF THE JUDGMENT BELOW were delivered via First Class Mail to the following:

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