EXCESS OF LOSS COVERAGE FOR SELF-INSURERS:

IS IT INSURANCE OR REINSURANCE (Revisited)?

By

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I. Introduction

Self-insurance entities often purchase excess of loss coverage from conventional insurers and reinsurers in order to meet the solvency standards of the self-insurers' supervising authorities. Often it is unclear whether this capacity must take the form of excess insurance or may take the form of reinsurance. The companies that provide this coverage sometimes structure it as reinsurance in order to be free of market conduct and rate and form regulation as well as premium taxes, guaranty fund assessments and other charges involved in direct insurance. However, the manner in which the coverage is styled may not be determinative when problems arise. The purpose of this article is to present selected case law as to whether this insurance or reinsurance is treated in several different self-insurance contexts.

II. Rate and Form Filings and Assessments

Commissioner of Insurance v. American Nat. Ins. Co., 410 S.W.3d 843 (Tex. 2012) involved stop loss coverage provided to qualified, self-funded employee benefit plans sponsored by various governmental and private entities. It is not clear from the opinion whether the relevant coverage documents were styled as policies or reinsurance contracts. However for financial statement purposes, the insurer treated the premiums it received as resulting from reinsurance assumed. During a routine audit, the Texas Insurance Department discovered this practice and alleged that the coverage was insurance rather than reinsurance and that the insurer should have paid premium taxes and complied with other regulatory strictures applicable to insurance.

After a detailed examination of Texas statutes, the court found the insurance code ambiguous on point but decided to defer to the position of the Insurance Department that the coverage was insurance and not reinsurance:

> The Department has therefore concluded that stop-loss insurance purchased by a plan does not involve two insurers and is therefore not reinsurance. It is instead direct insurance in the nature of health insurance because stop-loss policies are purchased by the plans ultimately to cover claims associated with their health-care expenses. The

Department's construction is reasonable, was formally promulgated, and is not expressly contradicted by the Insurance Code. We accordingly agree with the Department's construction and hold that stop-loss insurance sold to a self-funded employee health-benefit plan is not reinsurance, but rather direct insurance subject to regulation under the Insurance Code.[1]

III. Guaranty Fund Claims by Self-Insurers

In *Louisiana Safety Assoc. of Timbermen Self-Insurers Fund v. Louisiana Ins. Guaranty Association,* 17 So. 3d 350 (La. 2009) a workers compensation self-insurer purchased excess of loss coverage from Reliance Insurance Company which took the form of reinsurance contract. When Reliance became insolvent, the self-insurer sought coverage from the Louisiana Guaranty Association that excluded claims by any insurer. So the issue was whether the self-insured fund was an insurer, for guaranty association purposes, and, by implication whether the excess of loss coverage provided by Reliance was excess of loss insurance or reinsurance.

In analyzing this issue, the *Timbermen* court noted that Louisiana law exempted qualified self-insurers from some but not all laws and regulations pertaining to insurers. The court held that the fund functioned as an "insurer" for the purposes of this dispute and could not collect from the guaranty association. After examining the differences between excess insurance and reinsurance, and the fact that the Reliance documents were styled as reinsurance, the court held: [I]t is clear the contractual relationship between the Fund and Reliance presents a classic instance of reinsurance . . . ."[2] (Guaranty associations do not cover claims against insolvent reinsurers.) Thus, in Louisiana excess of loss coverage provided to self-insurers is reinsurance, at least for guaranty association purposes and as long as the coverage documents are styled accordingly.

A claim by a qualified workers compensation self-insurer against the South Carolina Guaranty Association provided the backdrop for *South Carolina Prop. and Cas. Guaranty Assoc. v. Carolinas Roofing and Sheet Metal Contractors Self-Insurance Fund*, 446 S.E.2d 422 (S.C. 1994). Mission Insurance Company, which had become insolvent, provided excess of loss coverage but it is not evident from the opinion whether the coverage was styled as insurance or reinsurance. The guaranty association denied the claim of the self-insurance fund on the bases that: (a) the self-insurance fund was an "insurer" which cannot make a claim against the guaranty association; and (b) the Mission coverage was reinsurance that is not covered by the association. The lower court found that the self-insurer was an "insurer" for purposes of the guaranty association coverage and that the Mission coverage was reinsurance.

The Supreme Court affirmed on the first basis and found that it did not have to reach the second issue. It noted that the self-insurer might not be an "insurance company" for other purposes of the insurance law but that it performed many of the functions of an "insurer" and should held to be such for purposes of the guaranty association law. If the self-insured fund was an "insurer", by implication Mission was a reinsurer. Therefore, in South Carolina, there is some precedent that excess of loss coverage provided to qualified self-insurers is reinsurance, at least for guaranty association purposes.

A multiple employer welfare fund formed pursuant to ERISA was the self-insurer involved in *New Hampshire Motor Transportation Assoc. v. New Hampshire Guaranty Assoc.,* 914 A.2d 812 (N.H. 2006). Legion Insurance Company provided the excess of loss coverage but it is not evident from the opinion whether the coverage was styled as insurance or reinsurance. When Legion became insolvent, the self-insurer sought to recover from the Life and Heath Guaranty Association. Again, the guaranty association denied the claim on the bases that the self-insurer was an "insurer" for purposes of guaranty fund law and that the Legion coverage was reinsurance. The lower court agreed and the Supreme Court affirmed.

The court found that regardless of whether the self-insurance fund was an "insurance company" for other portions of the insurance law, it was an "insurer" for purposes of the guaranty association law. The court found further that Legion provided reinsurance since it did not issue a direct health insurance policy *i.e.* it assumed the risk of the employers rather than that of their employees. Therefore, in New Hampshire excess of loss coverage provided to self-insurers is reinsurance rather than insurance, at least within the guaranty fund context.

Massachusetts Care Self-Ins. Group, Inc. v. Massachusetts Insurers Insolvency Fund, 937 N.E. 2d 939 (Mass. 2010) involved an excess of loss policy and a "cover note of reinsurance", both issued by Reliance National Indemnity Co. They were issued to a workers compensation self-insurance fund known as Mass Care. When the Reliance Group became insolvent, Mass Care made a claim against the guaranty fund. While the court debated statutory interpretation, the court's decision to treat the Mass Care as ineligible for coverage was driven by its view that Mass Care was part of the insurance industry and guaranty funds were formed to protect those outside this industry:

> [T]he legislative purposes underlying [the guaranty fund law] are fulfilled without permitting Mass Care to file a covered claim. The underlying injury suffered by Gorski resulted in a claim for workers' compensation benefits. Gorski, the injured employee, will receive these benefits whether Mass Care recovers from Reliance, recovers from the Fund, or receives no recovery at all. . . . While Mass Care may be required to increase the premium is charges its members if the claim is not covered by the Fund, no insolvency loss falls directly on a person outside the insurance industry.[3]

See also, Maryland Motor Truck Association Workers Compensation Self-Insurance Group v. Prop. and Cas. Ins. Guaranty Corp., 871 A.2d 590 (Md. Ct. App. 2005).

To the contrary is *Iowa Contractors Workers Compensation Group v. Iowa Ins. Guaranty Association,* 437 N.W. 2d 909 (Iowa 1989). In this case, the self-insurance fund had purchased excess insurance from Mission Insurance Company which styled its coverage as insurance. The court found that Iowa law excluded the self-insurance fund from insurance company status thus allowing the fund to make a claim against the guaranty fund. The court commented that this ruling was determinative of Mission's status as an insurer but went on note that the Mission coverage documents where characteristic of insurance

rather than reinsurance and, in any case, Mission paid premium taxes as an insurer, which reinsurers are not required to do.

Another case allowing a self-insurer to recover from the guaranty fund is *Levi Strauss & Co. v New Mexico Prop. & Cas. Guaranty Association,*816 P.2d 502 (N.M. 1991). Mission Insurance Company provided the excess workers compensation insurance and structured it as such, *i.e.* not reinsurance:

> First, the policies were never treated as reinsurance by Mission. Mission thought it was to pay premium tax on the policies even if it was done incorrectly. Also, testimony was provided by employees of Mission to the effect that these policies were not reinsurance policies and that Mission was not set up to write reinsurance but, instead, excess workers' compensation insurance for self-insured employers.[4]

The court went on to hold that Levi Strauss, as a self-insurer, was not an "insurer" for purpose of guaranty fund recoveries.

One or the more factually unusual cases in this category is *Alabama Ins. Guaranty Assoc. v. Assoc. of General Contractors,* 80 So. 3d 188 (AL 2010). AIGA was a qualified self-insurer providing workers compensation coverage to the employees of its members. Several such employers formed the Alabama Reinsurance Trust Fund to allow them to pool their liabilities above the retention levels of the individual members. The Trust Fund laid off a portion of its liability to Reliance National Indemnity Co. pursuant to a "Certficate of Reinsurance" which stated that it provide reinsurance to the Trust Fund, rather than any type of coverage to the individual employer members. Reliance witnesses maintained this the coverage was reinsurance, rather than excess insurance. However, the administrator of the Trust Fund provided an affidavit that the Trust Fund was merely a broker to obtain insurance for the Trust Fund members and the parties to the limitation entered into a stipulation consistent with this affidavit.

Based on the court's reading of Alabama law, plus an affidavit from the Alabama Insurance Department, the court concluded that neither the AIGA nor the Trust Fund were insurers for purposes of the guaranty fund law. The court also concluded that notwithstanding the fact that the Reliance Certificate of Reinsurance took the form of reinsurance, it could had to be treated as direct insurance since: (1) a reinsurer can only reinsurer a ceding insurer; and (2) neither the AIGA nor the Trust Fund are insurers. Therefore, the guaranty fund was required to pay the relevant claim on behalf of Reliance. As a result, in Texas, the guaranty funds will pay claims against excess of loss insurers even if such coverage is styled as reinsurance.

IV. Guaranty Fund Claims and Priority of Distribution Issues

All states have statutes that govern the priority of distribution of assets from the estate of an insolvent insurer.[5] Policyholders, claimants and guaranty funds are at the top of the list after administrative expenses. Reinsurance recoverables are at the bottom of the list with general creditors.

The flip side of the *Alabama Insurance Guaranty Assoc. case, §* II, *supra*, was handed down recently by the Pennsylvania Commonwealth Court, the court of original jurisdiction for Reliance Insurance Companies, in Liquidation. *Alabama Ins. Guaranty Assoc. v. Reliance Ins. Cos. In Liquidation,* 100 A. 3rd 702 (Pa. Commw Ct. 2014). Based on the decision of the Alabama Supreme Court that Reliance was providing insurance rather than reinsurance, the Alabama Guaranty Fund sought recovery from the estate of Reliance as a high priority creditor. The liquidator, however, allowed the claim only as a low priority, reinsurance recoverable claim.

The Commonwealth Court recited the facts of the Alabama decision that the self-insurance fund had pooled its liabilities into a Reinsurance Trust that purchased coverage from Reliance which took the form of reinsurance of the trust and not insurance or reinsurance of the individual members. The court cited an affidavit and stipulation clearly at odds with the facts of the coverage provided by Reliance. Agreeing with the Alabama Supreme Court that the characterization of such coverage can differ with the context, the Commonwealth Court held that the coverage provided by Reliance was reinsurance for priority of distribution purposes.

V. Excess of Loss Coverage for ERISA Benefit Plans

United Food & Commercial Workers Health and Welfare Trust v. Pacyga, 801 F.2d 1157 (9th Cir. 1986) involved an ERISA qualified employee benefit plan that had high excess of loss coverage, the nature of which is not described in the decision. At issue was a subrogation requirement for medical benefits that was prohibited under state law. The court found that ERISA exempted the plan from the regulation of insurance unless the plan was providing benefits through an insurer. The high excess (characterized as catastrophe) coverage did not amount to providing benefits through an insurer. Thus the court ruled that the self-insured fund was not an insurer for the purposes of insurance regulation. While the court made no ruling on point, the implication would seem to be that the excess of loss coverage was insurance and not reinsurance. *See also Brown v. Granatelle,* 897 F.2d 1351 5th Cir. 1990); *Cuttle v. Federal Employees Metal Trades Council,* 623 F.Supp. 1154 (D.Me. 1985).

VI. Direct Action by the Insured

Lincoln County Port Authority v. Allianz Global Risks US Ins. Co., 315 P.3d 934 (MT 2013) involved a municipal self insurance pool that purchased what the court characterized as excess of loss insurance from Allianz. (The decision does not elaborate on the form taken by the insurance.) One of the counties that was a member of the pool created a separate public entity called the Port to foster economic development. When one of the Port's buildings burned down a controversy arose as to whether the Port was an insured under the Allianz policy. As issue arose as to whether or not Allianz was actually acting as a reinsurer and if so, whether the Port was an insured that had no direct right of action against Allianz. However, the court held that the Port was Allianz's insured and that the burned building qualified as insurer property under the policy.

VII. An Outlier

American Eagle Ins. Co. v. Wisconsin Ins. Security Fund, 704 N.W. 2d 44 (Wis. App. 2005) is an example of using guaranty funds for social engineering. Wisconsin amended the guaranty fund law to allow town mutual insurance companies with insolvent reinsurers to make a claim against the guaranty fund. Such a claim was made and the fund assessed reinsurers of town mutual to pay the claim. A reinsurer which was assessed brought this action to avoid payment. While acknowledging that it was close case of statutory interpretation, the court allowed the assessment on the basis of giving deference to the guaranty fund that was charged with the authority to administer the guaranty fund law.

VIII. Commentary

Clearly, it is not possible to completely harmonize the caselaw cited above due to differences in the state and federal laws and regulations involved, the factual contexts in which the issues arise and the indirect way in which some of the decisions deal with insurer / reinsurer issue. However, there is some support for the proposition that excess of loss coverage provided to a qualified self-insurer in the form of reinsurance will be treated as such for regulatory and guaranty association purposes in some states.

ENDNOTES

[1] 419 S.W.3d 843 at 855.
[2] 17 So.3d 350 at 359.
[3] 937 N.E. 2d 939 at 947.
[4] 816 P.2d 502 at 505.
[5] Robert M. Hall, *Cedent's Claim to Reinsurance Recoverables and Priority of Distribution,* XII Mealey's Reins. Rpt. No. 12 at 20 (2001).