EXCESS OF LOSS COVERAGE FOR SELF-INSURERS:

IS IT INSURANCE OR REINSURANCE?

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 usually 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 this insurance or reinsurance is treated in three different self-insurance contexts.

II. Rate and Form Filings and Assessments

American National Ins. Co. v. Texas Department of Insurance, 2010 Texas App. Lexis 3005 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, as is demonstrated below, there were other characteristics consistent with reinsurance. For financial statement purposes, the insurer treated the premiums it received as resulting from reinsurance assumed.

During a routine examination, the Texas Insurance Department came across this coverage and ordered the insurer to amend its financials to treat it as insurance rather than reinsurance. Moreover, the department found the insurer to be in violation of its obligations to obtain form approval and to pay guaranty fund assessments, which would not be the case if the coverage was reinsurance.

After a detailed examination of Texas statutes, the court concluded that the self-insurers qualified as "insurers" with the authority to purchase reinsurance. Likewise, the court rejected the department's finding that the stop loss coverage was insurance rather than reinsurance:

> The way the policies function in this case is undisputed. In exchange for ceding a portion or all of its risk, a self-funded plan pays premiums to the Companies. If a covered loss occurs, the Companies make payments directly to the plans. The Companies have no contact with the individuals insured by the plans. All losses are handled by the plans and then sent to the Companies for indemnification. The Companies do not make coverage decisions with respect to individuals insured by the plans. The Companies have no contractual relationship with the individuals insured by the plans and cannot be sued by them. These are the classic characteristics of reinsurance as defined by Black and Appleman. . . . We therefore conclude that the stop-loss insurance in the context of this case is reinsurance.[1]

So in Texas, it appears that excess of loss coverage for qualified self-insurers that performs like reinsurance will be treated as reinsurance.

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 a reinsurance contract. When Reliance became insolvent, the self-insurer sought coverage from the Louisiana Guaranty Association which 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 *Timmermen* 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 fund was an "insurer" which cannot make a claim against the guaranty association; and (b) the Mission coverage was reinsurance which 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.

For cases reaching similar results in a guaranty association context, *see Massachusetts Care Self-Insurance Group, Inc. v. Massachusetts Insurers Guaranty Fund,* 2009 *M*ass. Super. Lexis 244; *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.

IV. 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).

V. Commentary

Clearly, it is not possible to completely harmonize the case law 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 substantial 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.

ENDNOTES

[1] 2010 Tex. App. Lexis 3005 (Tex.Ct.App.) *19.
[2] 17 So.3d 350 at 359.