

ASSUMPTION REINSURANCE AGREEMENTS

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Under assumption reinsurance¹ agreements, the ceding insurer cedes and the assuming insurer assumes all of the policyholder liabilities on in-force insurance policies and the assuming insurer becomes directly liable to the policyholders.²

The insurance codes in many states, including Kentucky,³ authorize domestic insurers to reinsure all or substantially all of their insurance in force or a major class thereof with another insurer by an agreement of assumption reinsurance filed with and approved by the Insurance Commissioner after a hearing held for that purpose. The Insurance Commissioner is required to approve the agreement within a reasonable time after filing unless he finds that (i) it is inequitable to each insurer and the policyholders involved, or (ii) it will substantially reduce the protection of and service to the policyholders of the domestic insurer, or (iii) the agreement does not contain adequate provisions by which the assuming insurer becomes liable to the policyholders, or (iv) the assuming insurer is not authorized to transact the same class of insurance in the state, or (v) the agreement would materially tend to lessen competition in insurance business, or (vi) the agreement is not free from other reasonable objections.

Neither the Kentucky Insurance Code nor similar insurance codes require the policyholders to consent to the assumption of their policies or provide that the ceding insurer is released from liability to the policyholders.⁴ Nevertheless, some ceding insurers believe that assumption reinsurance agreements approved by the Insurance Commissioner of the ceding insurer's domicile releases them from liability to the policyholders.

The issue of whether the ceding insurers are released from liability to the policyholders without the policyholders' consent was settled when assuming insurers defaulted on reinsured policies and the courts held that the ceding insurers remained liable to the policyholders because a common law novation had not occurred.⁵

A novation occurs when a new debtor is substituted for an old debtor and the old debt is extinguished. A novation of an insurance policy requires the agreement of the ceding insurer and assuming insurer and the consent of the policyholder to the assuming insurer's assumption of the policyholder's contract and to the release of the ceding insurer from liability on the policyholder's contract.⁶ If the ceding and assuming insurer agree to an assumption reinsurance agreement, but the policyholder does not consent, both the ceding insurer and the assuming insurer are directly liable to the policyholder.⁷

Novation is never presumed. The party asserting it has the burden of proving its essential elements and mere acquiescence to an assumption of an insurance policy does not constitute a consent to novation.⁸

A novation depends on the intention of the parties.⁹ While consent to a novation may be implied from the circumstances and the parties' conduct, a policyholder's consent cannot be implied or inferred if the policyholder was not given an opportunity to reject the assumption, even though he submitted claims to the assuming insurer.¹⁰

In 1991 the National Association of Insurance Commissioners ("NAIC") commenced reviewing assumption reinsurance agreements and related issues. In December 1993 the NAIC adopted the Assumption Reinsurance Model Act (the "Model Act").¹¹

The Model Act defines assumption reinsurance agreements as contracts which transfer insurance obligations and/or risks of existing or in-force contracts of insurance from a ceding insurer to an assuming insurer, and which are intended to effect a novation of the transferred contract of insurance with the result that the assuming insurer becomes directly liable to the policyholders of the ceding insurer and the ceding insurer's insurance obligations and/or risks under the contracts are extinguished.¹²

The Model Act applies to all domestic and authorized foreign insurers in the state which either cedes or assumes contracts of insurance pursuant to an assumption reinsurance agreement.¹³

The Model Act does not apply to:¹⁴

- A reinsurance transaction in which the ceding insurer remains directly liable to the holder of the reinsured policy.

- The transfer of insurance contracts pursuant to regulated mergers or consolidations.
- The substitution of insurers upon the expiration of insurance coverage.
- An insurer subject to judicial order of liquidation or rehabilitation.
- A reinsurance transaction to which a state guaranty association is a party provided the policyholders do not lose any rights or claims afforded under their original policies.
- The transfer of liabilities from one insurer to another under a single group policy upon the request of the group policyholder.

The Model Act requires that the ceding insurer send notices of transfer of the reinsured policies to the policyholders and the agents and brokers of record of the reinsured policies. The notices must be sent by first class mail, or by personal delivery with an acknowledged receipt in the case of home service business.¹⁵

The notices must include (i) the date of transfer, (ii) the name, address and telephone number of both insurers, (iii) a statement that the policyholder has the right to accept or reject the transfer and novation, (iv) the procedure and time limit for accepting or rejecting the transfer and novation, (v) a statement that the assuming insurer is licensed or otherwise authorized to write the type of policies being reinsured, (vi) the name and address of the person at the ceding insurer where consents or rejections can be sent, (vii) the address of the policyholder's insurance department, (viii) specified rating and financial information, (ix) an explanation of the reason for transfer, and (x) a response card to be returned by the policyholder.¹⁶

Policyholders may accept or reject the transfer and novation by returning the response card with their choice marked thereon. Payment of premiums within 24 months after the transfer will constitute consent to the transfer if the premium notice states that payment constitutes consent. However, the premium notice must also provide a method for the policyholder to pay the premium while reserving the right to reject the transfer.¹⁷

If within 24 months a positive acceptance or rejection is not received by the ceding insurer, whether by the policyholder returning the response card or in conjunction with the payment of premiums, the ceding insurer is required to send a final notice. If the policyholder does not accept or reject the transfer within one month after the final notice is mailed, the policyholder will be deemed to have given his consent and a novation shall have been effected.¹⁸

The Model Act also requires the assumption reinsurance agreement to be approved by the Insurance Commissioners in the states in which both the ceding and assuming insurers are domiciled.¹⁹

In addition, the Model Act prohibits:²⁰

- An insurer licensed in the state from ceding business in that state to another insurer not licensed in that state.
- An insurer domiciled in the state from assuming business in any other state unless it is licensed in that state or the Commissioner in that state has approved the assumption.
- Licensed foreign insurers from entering into assumption reinsurance agreements that transfers policies in the state unless approved by the Insurance Commissioner in the state and is subject to all other requirements of the Model Act, unless both the ceding and assuming insurer are subject to assumption reinsurance requirements adopted by statute or regulation which are substantially similar to the Model Act.

As of July, 1999, only 9 states²¹ had adopted the Model Act or similar legislation.

Ceding insurers domiciled in the states that do not require the consent of the policyholders to an assumption reinsurance arrangement should obtain the consent of policyholders if they want to be released from liability on the reinsured policies.

Endnotes

1. Assumption reinsurance is sometimes called bulk or substitution reinsurance.
2. Under indemnity insurance agreements, the ceding insurer is directly liable to the policyholders and the assuming insurer is liable to the ceding insurer.
3. Kentucky Revised Statutes § 304.24-420.

4. A provision that the ceding insurer is released from liability to the policyholders without the policyholders' consent would abrogate the common law of novation. An intention to abrogate common law will not be presumed, assumed or inferred and any attempt to repeal the common law by statute must be clearly apparent. *Day v. Day*, 937 S.W. 2d 717 (Ky. 1997); *Stovall v. A. O. Smith Corp.*, 676 S.W. 2d 475 (Ky. App. 1997); *James v. Churchill Downs, Inc.*, 620 S.W. 2d 323 (Ky. App. 1981); *Baer v. Associated Life Insurance Co.*, 202 Cal. App. 3d 117 (Cal. App. 1988).
5. *Security Benefit Life Ins. Co. v. Federal Deposit Insurance Corp.*, 804 F. Supp. 217 (Kan. 1992); *Travelers Indemnity Company v. Gillespie*, 785 P. 2d 500 (Cal. 1990); *Baer v. Associated Life Ins. Co.*, 202 Cal. App. 3d 117 (Cal. App. 1988); *Prucha v. Guarantee Reserve Life Ins. Co.*, 358 So. 2d 1155 (Fla. App. 1978). (Check for additional cases.)
6. Black's Law Dictionary, Sixth Edition; Restatement of Contracts (Second) § 280.
7. *Travelers Indemnity Company, et al. v. Gillespie*, 50 Cal. 3d 82 (Cal. 1990).
8. *Security Benefit Life Ins. Co. v. Federal Deposit Insurance Corp.*, 804 F. Supp. 217 (Kan. 1992).
9. *Wabash Life Insurance Company v. Comer*, 426 S.W. 2d 444 (Ky. 1967).
10. *Baer v. Associated Life Insurance Company*, 202 Cal. App. 3d 117 (Cal. App. 1988).
11. NAIC Assumption Reinsurance Model Act.
12. *Id.* § 3.
13. *Id.* § 2.
14. *Id.* § 2.
15. *Id.* § 4.A.
16. *Id.* § 4.B.
17. *Id.* § 5.
18. *Id.* § 5.
19. *Id.* § 4.B.
20. *Id.* § 4.B.
21. Colorado, Georgia, Maine, Missouri, Nebraska, North Carolina, Oregon, Rhode Island, and Vermont.