REINSURANCEFOCUS
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Treaty Tip: Is it an Insurance Policy or a Reinsurance Agreement?

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Whether a risk shifting agreement is an insurance policy or a reinsurance agreement may have important consequences. For example, many states prohibit the mandatory arbitration of disputes arising out of insurance policies, while there is a history and industry custom of resolving many disputes arising out of reinsurance agreements through mandatory arbitration. If a reinsurance contract is interpreted to be an insurance policy disputes may not be subject to arbitration in some states, invalidating an important provision of the reinsurance agreement. A recent opinion found that a document titled a Facultative Reinsurance Agreement was in fact an insurance policy, and the court affirmed the denial of a motion to compel the arbitration of a dispute under the contract because applicable Missouri law prohibits the mandatory arbitration of disputes arising out of insurance policies. *Leonberger v. Missouri United School Insurance Council*, -- S.W.3d --, 2016 WL 2994332, No. ED103669 (Missouri Court of Appeals May 24, 2016).

The court's analysis addressed the differences between a contract of insurance and a reinsurance contract, stating that an insurance contract provides indemnity against liability while a reinsurance contract provides indemnity against loss, with the reinsurer becoming liable only after the reinsured has paid the loss. The court found that certain provisions of the contract which permitted the "reinsurer" to participate in and exercise some control over the claims process and the accrual of liability to the underlying insurer transformed the reinsurance contract into a contract of insurance.

The notable feature of the opinion is that the court found that one contractual provision which is somewhat common to reinsurance contracts, a following form provision, contributed to the conclusion that the contract was in fact an insurance contract. This reinsurance agreement also contained provisions permitting the reinsurer to participate and exercise some control over the defense and settlement of claims submitted under the underlying insurance contract, providing the reinsurer extensive rights to participate in the underlying insurance claim, including the right to approve the selection of counsel to represent the insurer; to receive direct notice of claims on the underlying insurance; to associate in the defense and control of claims and trials; to retain sole discretion to take over the defense of any claim or suit; and to exercise the defense and settlement rights with respect to the claims of the insureds. Not all reinsurance agreements provide the reinsurer such extensive rights, and the exercise of such powers by a reinsurer is almost the antithesis of a follow- the-fortunes provision, a common provision in reinsurance agreements.

Treaty drafting tip: The key to this opinion appears to be the extent to which the reinsurer had the right to control, as opposed merely to participate in, the consideration, investigation, handling and disposition of claims against the underlying insurance. Care must be taken in drafting reinsurance agreements to ensure that this line is not crossed, and that a proper balance is achieved between providing the reinsurer the ability to participate in mitigating the ultimate loss on the reinsurance contract, should it wish to do so, while not usurping the rights of the insurer and turning the reinsurance agreement into an insurance policy. Ordinarily, the presence of a follow-the-fortunes provision in the reinsurance agreement should help to avoid a finding that the reinsurance agreement is an insurance policy.

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