STATE OF NEW YORK
INSURANCE DEPARTMENT
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Governor

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OGC Op. No. 08-07-15

The Office of General Counsel issued the following opinion on July 21, 2008, representing the position of the New York State Insurance Department.

Re: Assumption Reinsurance/Novation

Question Presented:

1) Must an insured's consent be obtained to effectuate a transfer of the insured's insurance contract to another insurer that is assuming all the rights, responsibilities and functions of the original underwriting insurer?

2) Does the New York Insurance Law require assumption reinsurance transactions involving only foreign insurers[1] (save for life insurers) to be filed with the New York State Insurance Department for approval?

Conclusion:

1) Yes. An insured's consent must be obtained to effectuate a transfer of the insured's insurance contract to another insurer that is assuming all the rights, responsibilities and functions of the original underwriting insurer.

2) No. The New York Insurance Law does not require assumption reinsurance transactions involving only foreign insurers (save for life insurers) to be filed with the New York State Insurance Department.

Facts:

An inquirer presented questions about surety insurance[2] that had been transferred to a reinsurer under an assumption reinsurance agreement, where the ceding insurer and reinsurer were both foreign insurers.

Analysis:

"Assumption reinsurance" is defined in Dictionary of Insurance Terms (3rd ed. 1995) as a "form of insurance whereby the buyer (reinsurer) assumes the entire obligation of the cedent company, effected through the transfer of the policies from the cedent to the books of the reinsurer." Id. at 40. Thus, in assumption reinsurance, the reinsurer assumes all of the functions formerly handled by the original underwriting insurer, including but not limited to claims handling and payment, premium acceptance and return, and policy amendment, issuance, and cancellation. Assumption reinsurance is also commonly referred to as a "novation," a general contract term defined by Black's Law Dictionary (8th ed. 2004) as "[t]he act of substituting for an old obligation a new one that either replaces an existing obligation with a new obligation or replaces an original party with a new party." Id. at 1094.

In contrast, in a transaction involving the more common form of reinsurance, "[a]n insurer (*the reinsured*) reduces its possible maximum loss on either an individual risk (facultative reinsurance) or a large number of risks (automatic reinsurance) by giving (*ceding*) a portion of its liability to another insurance company (*the reinsurer*)." See Dictionary of Insurance Terms 397 (3rd ed. 1995). The reinsurer is not directly liable to insureds and is does not assume the functions of the original underwriting insurer. Rather, such reinsurance binds only the underwriting ("ceding") insurer and the reinsurer, with no rights accruing to insureds or third party claimants.

N.Y. Ins. Law § 1308 (McKinney 2006) sets the general parameters for reinsurance transactions in New York. That statute

reads in pertinent part as follows:

> (a)(1) Any authorized insurer, hereinafter called the "ceding insurer," may, subject to the limitations of this chapter, reinsure its risks and policy liabilities in any other assuming insurer with the effects herein prescribed. No prohibition or limitation in this chapter shall invalidate any reinsurance agreement as between the parties thereto.
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> (2)(A) No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after January first, nineteen hundred forty, unless:
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> (i) the reinsurance shall be payable by the assuming insurer on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer, and
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> (ii) under the reinsurance agreement the liability for such reinsurance is assumed by the assuming insurer as of the same effective date.
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> (B) Except as provided by subsection (a) of section four thousand one hundred eighteen of this chapter, no such credit shall be allowed any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after September first, nineteen hundred fifty-two, unless the reinsurance agreement provides that payments by the assuming insurer shall be made directly to the ceding insurer or its liquidator, receiver or statutory successor, except where:
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> (i) the agreement specifies another payee of such reinsurance in the event of the insolvency of the ceding insurer, or
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> (ii) the assuming insurer with the consent of the direct insureds has assumed such policy obligations of the ceding insurer as its direct obligations to the payees under such policies, in substitution for the obligations of the ceding insurer to such payees.

A ceding insurer that does not comply with Insurance Law § 1308(a)(2) may not offset the amount of reinsurance it ceded as an admitted asset or liability deduction against its loss reserves. Because failure to comply with Insurance Law § 1308 requirements does not invalidate a reinsurance agreement – rather, noncompliance merely prohibits a ceding insurer from taking credit for the amount of reinsurance ceded – Insurance Law § 1308 is not a statutory mandate that requires an insured's consent to effectuate an assumption reinsurance agreement. Instead, it is the common law of contracts that requires an insured's consent to such novation.[3]

New York common law requires four elements to prove a novation: "(1) a previously valid obligation; (2) agreement of all parties to a new contract; (3) extinguishment of the old contract; and (4) a valid new contract." See Israel v. Chabra, 418 F. Supp. 2d 509 (S.D.N.Y. 2006); Healey v. Healey, 190 A.D.2d 965 (3rd Dep't 1993); P.C. Chipouras and Assocs., Inc. v. 212 Realty Corp., 156 A.D.2d 549 (2nd Dep't 1989). As stated by the New York Court of Appeals – the state's highest court - in Griggs v. Day, 136 N.Y. 152, 160 (1892): "It usually, if not always, takes three parties to make a novation, and they must all concur upon sufficient consideration in making a new contract to take the place of another contract, and in substituting a new debtor in the place of another debtor. Novation is thus briefly defined: A transaction whereby a debtor is discharged from his liability to his original creditor by contracting a new obligation in favor of a new creditor by the order of the original creditor."

State of New York v. Empire Mut. Life Ins. Co., 92 N.Y. 105 (1883) is illustrative. There, the defendant had entered into a contract with another insurer, Continental Life Insurance Company, to reinsure all of Empire's risks. Empire transferred all of its assets to Continental, and then closed its business. Seven years later, Empire was dissolved and a receiver was appointed. Thereafter, Continental went into liquidation. While Continental was in operation, some of Empire's insureds consented to the reinsurance transaction and accepted Continental as its new insurer. There were other policyholders, however, who refused or neglected to accept the Continental policies. The court stated: "An insurance company has no power to turn its policyholders against their consent over to another company, and such policyholders are under no obligation, in order to protect their legal rights, to protest against an effort to do so." 92 N.Y. 110. Thus, in response to the inquirer's first query, New York common law requires an insured's consent to effectuate a transfer of his insurance contract to another insurer that is assuming all the rights, responsibilities and functions of the original underwriting insurer.

However, such consent need not be formally provided; it may be inferred from the circumstances. See Schloss Bros. & Co.

v. Bennett, 260 N.Y. 243 (1932); Kinsella v. Merchants Nat. Bank & Trust Co. of Syracuse, 34 A.D.2d 730 (4th Dep't 1970). Hence, an insured who, for example, remits his insurance premiums to, files claims with, and requests policy changes through the assuming reinsurer could be found to have consented to the novation.

The inquirer's second question asks whether the Insurance Law requires assumption reinsurance transactions involving only foreign insurers providing surety bonds to be filed with the Department for approval. Insurance Law § 1308(e), which requires the Superintendent's permission to cede insurance under certain circumstances, is relevant to the inquiry. That statute states in relevant part:

> (1) During any period of twelve consecutive months, without the superintendent's permission:
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> (A) no domestic insurer, except life, shall by any reinsurance agreement or agreements cede an amount of its insurance on which the total gross reinsurance premiums are more than fifty percent of the unearned premiums on the net amount of its insurance in force at the beginning of such period,
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> * * *
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> (3) If any agreement or agreements at any time effect reinsurance of substantially all of the net insurance in force of such ceding insurer, no credit by way of deduction pursuant to subsection (b) hereof shall be allowed to such ceding insurer, unless either:
> (A) the assuming insurer or insurers assume or have assumed the policy obligations of the ceding insurer as their direct obligations to the obligees under such policies and the provisions for cancellation, if any, of such reinsurance agreements have been approved by the superintendent,

Thus, while the Insurance Law requires certain reinsurance transactions of domestic insurers[4] to be filed with the Superintendent, the Insurance Law does not require assumption reinsurance transactions involving only foreign insurers (save for life insurers) to be filed with the Superintendent. With respect to the facts conveyed in the inquiry, this Department would have had no statutory authority to approve or disapprove the assumption reinsurance agreement entered into by the original underwriting insurer and the assuming reinsurer.

For further information you may contact Associate Attorney Sally Geisel at the New York City Office.

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[1] Insurance Law § 107(a)(21) defines a foreign insurer as "any insurer incorporated or organized under the laws of any state, as herein defined, other than this state."

[2] "Fidelity and surety" insurance is a kind of authorized insurance and includes "any contract bond; including a bid, payment or maintenance bond or a performance bond where the bond is guaranteeing the execution of any contract other than a contract of indebtedness or other monetary obligation." See N.Y. Ins. Law § 1113(a)(16)(C).

[3] An Insurance Law § 1308(a)(2)(B)(ii) transaction is a novation. Indeed, Office of General Counsel Opinion dated November 18, 1952 states: "The purpose of the 1952 amendment to Section 77 was to deny credit for reinsurance to a ceding insurer where a reinsurance agreement covering the kinds of risks other than those written pursuant to Section 315, provides, in the case of insolvency of the ceding insurer, for the payment by the assuming reinsurer direct to the policyholder in the event of loss, unless there is an actual novation whereunder the policyholder releases the ceding insurer and accepts liability solely of the reinsurer." The Insurance Law was recodified in 1985. Former Insurance Law § 77 was recodified as section 1308, and former Insurance Law § 315 is now section 4118. Insurance Law § 4118 permits a surety insurer to accept risks in excess of the 10% threshold established in Insurance Law § 1115 by entering into a reinsurance agreement that enables the obligee or beneficiary of the surety insurance to maintain an action directly against the insurer and the reinsurer jointly. Insurance Law § 4118, however, does not contemplate a novation. It only provides that an insured may seek to enforce its policy against the reinsurer directly. See Office of General Counsel Opinion dated November 27, 1950.

[4] Insurance Law § 107(a)(19) defines a "domestic insurer" as "any authorized insurer incorporated or organized under any law of this state. See also Insurance Law § 1505(d)(2) with respect to transactions between a domestic insurer and another member of its holding company system.