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Illinois Coverage Basics

Are Self-Insured Retentions (SIRs) Insurance or Not?

A self-insured retention (SIR) is a risk management mechanism that shares some of the essential characteristics of commercial insurance and some characteristics of having no insurance at all. SIRs are sometimes treated as the functional equivalent of insurance, but quite as often they are treated as the antithesis of insurance. It makes a big difference which characterization is employed, because significantly different rules apply to insurance than to other risk management devices. In Illinois, the answer to this question is largely a matter of public policy.

What Is a Self-Insured Retention?

Part of the challenge in answering whether SIRs are "insurance" is that SIRs are creations of contract, and they do not all operate in the same way. The distinguishing points are generally that commercial insurance involves at least two separate parties: an insurer and an insured. In contrast, a self-insured retention typically involves only one party: the self-insured. Commercial insurance involves a shifting of risk from one party to another, and terms of commercial insurance are normally set forth in a detailed policy document. In contrast, SIRs involve no shifting of risk; instead, the risk is retained by the insured itself. The terms of self-insurance may or may not be set forth in a detailed document. Finally, while insurance is regulated, self-insurance ordinarily is not.

Why It Matters Whether SIRs Are Considered to be Insurance or Not

Whether an SIR is deemed to be insurance or not insurance impacts the application of several important Illinois insurance law rules. First, targeted tenders can be directed to insurance policies, but not to SIRs. Second, an insurer that has paid a loss may seek equitable contribution or equitable subrogation from other insurance policies, but equitable contribution or equitable subrogation cannot be sought against SIRs. Third, "other insurance" clauses control the priority of application among insurance policies, but they do not govern the application of SIRs. Similarly, the rule of horizontal exhaustion that requires certain policies to perform before others has no impact on the application of SIRs.

State Farm v. DuPage County

A recent ruling of the Illinois Appellate Court provides a helpful starting point for understanding how self-insured retentions are treated under Illinois law. In State Farm Mutual v. DuPage County, 2011 WL 2471920 (2nd Dist., June 16, 2011), the Court was called upon to decide whether State Farm could obtain equitable subrogation from DuPage County, which was self insured for $2 million and covered by commercial excess insurance above the SIR. After paying a claim for injuries caused by a County employee, the insurer filed an equitable subrogation claim against the County seeking reimbursement. State Farm argued that it should be entitled to

obtain equitable subrogation from the County, analogizing the County's SIR to commercial insurance. However, the County argued to the contrary, insisting that its SIR was not insurance.

The Appellate Court in the DuPage County case relied upon prior case law holding that self insurance that is funded through a municipal risk pool does not constitute "insurance" under Illinois law. The rationale for the rule is a practical one. By ruling that SIRs funded through municipal risk pools do not qualify as "insurance," courts insulate municipal SIRs from third-party recovery actions, which in turn preserves public funds. Although DuPage County's SIR was entirely self funded, not funded by a municipal risk pool, the Appellate Court held that the SIR should not be considered to be insurance. Since public funds would be exposed if State Farm was allowed to seek equitable subrogation against the County's SIR, the Appellate Court held that the SIR would not be deemed to be insurance.

The Appellate Court acknowledged that when self insurance is funded through a risk pool that does not involve public funds, courts may reach the opposite conclusion. For example, SIRs funded through the Chicago Risk Hospital Pooling Program are deemed to be insurance because public funds are not at risk. *See* Chicago Hospital Risk Pooling Program v. Illinois State Medical Inter-Insurance Exchange, 325 Ill.App.3d 970, 983, 758 N.E.2d 353, 363 (1st Dist. 2001).

Other Considerations for Navigating the Self-Insurance/ Insurance Question

In cases not involving public funds, the decisions are mixed. In two fact patterns the Illinois courts rule that SIRs are not insurance because that characterization best protects the interests of insureds. Illinois has generally rejected attempts by commercial carriers to treat SIRs as insurance for purposes of applying "other insurance" clauses. USX Corp. v. Liberty Mutual Insurance Co., 269 Ill.App.3d 233, 243, 645 N.E.2d 396, 403 (1st Dist. 1994). Accordingly, efforts by insurers to compel contribution from SIRs under "other insurance" clauses ordinarily fail. For similar reasons, where equitable contribution or equitable subrogation is sought from self insurance, courts resist characterizing SIRs as "insurance," because the equitable remedies were created for the purpose of allowing insurers to recover from other insurers, not insureds.

Nonetheless, Illinois courts routinely find that SIRs do constitute insurance in situations where a continuing loss triggers policies in multiple periods. *See* Missouri Pacific R. Co. v. International Insurance Co., 288 Ill.App.3d 69, 82, 679 N.E.2d 801, 810 (2nd Dist. 1997). The rationale for this apparently inconsistent result is that an insured who chooses to go without insurance for a period of time should not be entitled to have other insurers cover the uninsured period by way of a subsequent allocation among insurers.

Sometimes SIRs are treated as insurance; sometimes they are not. It is primarily a results-determined analysis. Courts find that SIRs are not "insurance" whenever public funds are at risk, and courts generally are reluctant to compel insureds to perform as insurers under self-insurance programs. However, exceptions in the case law provide grounds for arguments to the contrary.

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