

ALSTON & BIRD



Life Insurance Class Action 2021 Updates and Trends

Bo Phillips
Alston & Bird
San Francisco / Los Angeles

Federation of Defense and Corporate Counsel
2021 Annual Meeting
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Class Action Updates

- (1) Life Insurance Cases
- (2) Annuity Litigation
- (3) Recent Trends and Key Strategies



History Of Class Actions Targeting The Life Insurance Industry

- 1990s – Vanishing Previous / Illustration Fraud
- 2000s – Cost of Insurance Increases
- 2005-2015 – Annuity Sales Practices
- 2015-2021 – COI2.0: Duty to Decrease Rates



COI Class Actions Since *Norem/Thao*

- COI increases by Lincoln National, John Hancock, Transamerica, State Farm, Banner Life, Connecticut General, AXA, Genworth and others have all been challenged.
- Any COI increase will be scrutinized by class action plaintiffs' lawyers and the life settlements industry.
- Plaintiffs have been successful in directing cases to sympathetic courts in California, New York and Missouri.
- Many recent decisions have not been favorable to the industry.
- Two recent cases have gone to trial with negative results for the industry.



COI Class Actions Since *Norem/Thao*

- **Typical Claims:**
 - Breach of contract
 - Restitution
 - Conversion
 - Injunctive relief
- **General Allegations:**
 - Some complaints allege that COI charges breach the contract from the outset because even the initial charges build-in expense recovery.
 - Some complaints also assert that the carrier has a duty to decrease COI charges in response to improvements in mortality rates.
 - Other complaints allege COI rate increase breached the contract.



COI Class Actions Since *Norem/Thao*

- There are a number of COI related decisions, verdicts and/or settlements since *Norem/Thao*.
- Most of these decisions have rejected or distinguished *Norem/Thao*'s interpretation of the term "based on" to mean that an insurer could consider anything not specifically delineated in the policy.
- Federal courts in Missouri, California, New York and Connecticut have all adopted a restrictive interpretation of the term "based on" to mean that the insurer may only consider the factors specifically listed in the policy. See *Vogt v. State Farm Life Ins. Co.*, 963 F.3d 753 (8th Cir. 2020); *Bally v. State Farm Life Ins. Co.*, 335 F.R.D. 288 (N.D. Cal. 2020); *Fleisher v. Phx. Life Ins. Co.*, 18 F. Supp. 3d 456 (S.D.N.Y. 2014); *Palumbo v. Nationwide Life Ins. Co.*, No. 3:16-cv-01143-WWE, 2017 U.S. Dist. LEXIS 2691 (D. Conn. Jan. 9, 2017).



COI Class Actions Since *Norem/Thao*

- Most courts finding relevant contract language to be ambiguous have construed it against the insurer, ignoring some of the jurisprudence regarding the doctrine of *contra proferentum*.
- One state court in Indiana held that “based on” unambiguously limits the insurer to consider only “factors” listed in the policy. *Lincoln Nat’l Life Ins. Co. v. Bezich*, 33 N.E.3d 1160, 1168 (Ind. Ct. App. 2015), *transfer granted and vacated*, 37 N.E.3d 493 (Ind. 2015).
- Courts have also rejected arguments that a carrier can set rates at any level below the policy’s Guaranteed Maximum Rates, holding that the term “based on” restricts the COI factors the carrier may consider to those listed in the policy.



COI Class Actions Since *Norem/Thao*

- At least one court has rejected the argument that insurers have a duty to reduce COI charges in response to mortality rate improvements absent language in the policy requiring the insurers to periodically review and reset COI rates. *See, e.g., Kalodner v. Genworth Life & Annuity Ins. Co.*, 262 F. Supp. 3d 218, 226 (E.D. Pa. 2017).



Examples of Theories Alleged by Plaintiffs (COI Rate Increases)

- **Basic theory**: COI rate provisions do not permit COI rate increases, because the increases are not based (or based solely) on the multiple so-called “factor(s)” listed in the policies, or, depending on the contract language, the COI rate is not based solely on anticipated mortality rates.
- **Improper motive/bad faith theory**: Some plaintiffs have alleged improper motives, such as inducing lapses or unfairly discriminating against certain categories of policies (such as investor-owned).



Examples of Theories Alleged by Plaintiffs (COI Rate Increases)(cont'd)

- **Diluting guaranteed interest rate theory**: Some plaintiffs have alleged that the insurer was motivated to increase rates based on interest rate spread not meeting insurers' expectations.
- **"Baked in" losses theory**: Argument is that increases are improper when initial pricing projections included losses in later policy years.
 - Losses are "baked in," and a COI rate increase is permissible only if expected mortality rates have deteriorated, as compared to original pricing assumptions.



Examples of Theories Alleged by Plaintiffs (COI Rate Increases)(cont'd)

- **The Implied Covenant of Good Faith & Fair Dealing**: Plaintiffs argue that discretion is limited by some duty of good faith despite the inclusion of maximum COI rates.
- **Recouping past losses theory**: COI rate increase designed to recoup past losses or effectively recoups past losses because it increases profits beyond initial targets.
- **Unfair classification**: Plaintiffs argue that insurer applies COI changes to “classes” that include different risks and that are not actuarially justified.
- **Unreasonable assumptions**: The use of unreasonable assumptions either at original pricing or at time of increase results in excessive profits.



Examples of Theories Alleged by Plaintiffs (COI Rate Increases)(cont'd)

- **COI charges are to “cover” (and may only “include”) projected mortality**
 - The concept underlying how plaintiffs say COI rates should be set is invalid.
 - The actual pricing of UL products and the contract math are not as simple as plaintiffs claim.
 - There are multiple, potentially reasonable approaches to re-determining COI rates for a product.
- **Reinsurance is not properly considered as an “expense”**
 - Use and cost of reinsurance has changed since initial pricing.
 - Treated as a separate category in pricing analysis.
- **Increase is not “uniform”**
 - Increases may impact some within class more than others.
 - Banding or other classification may be discriminatory.
 - Actuarially justified adjustments to specific cells may be discriminatory.



Lessons Learned Defending COI Increases

- First and foremost, attorneys should be involved from day one because of the expectation that litigation will likely ensue.
 - **Caution:** Conversations with inside counsel have, in some instances, not been afforded privileged/protected status because counsel was found to be acting in a business capacity.
 - Attorney-client privilege is subject to waiver.
- There is no silver bullet or “one size fits all” approach to making a COI increase ironclad.
 - Each situation is different and requires extensive analysis and investigation of the differing factors and issues at play.
 - Prudence requires detailed actuarial and legal analysis for any COI increase.



Lessons Learned Defending COI Increases (cont'd)

- **Important Note:**
 - The following observations do not guarantee success.
 - They also are not requirements or rules.
 - Each carrier needs to assess its own situation individually and determine the best course of action for implementing a COI increase based on its individual situation and the advice of its experts and attorneys.



Lessons Learned Defending COI Increases (cont'd)

- **Focus on fairness to policyholders.**
 - Should be manifested in the analysis and documentation.
- **Research and understand original pricing process, methods and variables used at product introduction.**
 - Pricing may have occurred long before acquisition of policy block.
- **Vocabulary Matters.**
 - Includes vocabulary used in internal e-mails, customer communications and elsewhere.
 - *E.g.*, COI rates are not “calculated” and do not have “components.”



Lessons Learned Defending COI Increases (cont'd)

- **The actuarial facts and analysis matter.**
 - Important to help establish affirmative and defensive arguments.
 - Will want to consult with counsel to understand which actuarial facts may be helpful/harmful given the company's individual circumstances.
- **Consistency matters.**
 - If different considerations require a deviation from prior practices, consider explaining and documenting the necessity for the deviation.
- **The differences in and evolution of COI provisions over time matter.**
 - Plaintiffs will compare and contrast differing COI provisions and will track changes in provisions over time to try to create favorable arguments.
 - Important to understand in advance how these differences might play out in litigation.



Lessons Learned Defending COI Increases (cont'd)

- **Carefully consider existing records (including e-mails) to make a proper risk assessment.**
 - The content of these documents cannot be changed or avoided.

- **Be cognizant of potential allegations of unreasonable discrimination.**



Lessons Learned Defending COI Increases (cont'd)

- **COI rates come as scales.**
 - The reasonableness of each rate in the scale depends on the rest of the scale.
 - Conduct a careful review of the entirety of all inputs of the actuarial model and the various relationships involved.
- **Consider how COI scales compare to expected mortality at inception and over time.**
- **Consider whether the pricing horizon in the original modeling has passed for some policies.**



Summary of Defending COI Increases

- No court has provided clear guidance how to effectuate a COI change.
- A key question is how the insurer has, should, or must relate a change in mortality expectations to COI rates based on a careful review of the company's facts, policy language and circumstances and the related emerging law.



The Current State of Index Annuity Class Actions

- History of major class actions (2005-2017)
 - Alleged misleading disclosures
 - Class wide suitability challenges
 - “Illusory bonus” and commission recoupment allegations
- Large class action settlements by major players
- Key cases in Central District of California
- Industry wins in *Eller v. EquiTrust Life Ins. Co.*, 778 F.3d 1089 (9th Cir. 2015) and *Chambers v. N. Am. Co. for Life & Health Ins.*, No. 4:11-cv-00579-JAJ-CFB, ECF No. 346 (S.D. Iowa March 31, 2017) (granting defendant’s motion for summary judgment)



The Current State of Index Annuity Class Actions

- RICO class actions arising out of marketing and performance of “proprietary” index crediting options
- ***Ogles v. Security Benefit*, 401 F. Supp. 3d 1210 (D. Kan. 2019)**
 - Challenge to product design
 - Alleged concealment of financial condition
 - Attack on disclosures and illustrations
 - Motion to dismiss granted and appeal dropped



The Current State of Index Annuity Class Actions

- ***Clinton v. Security Benefit***, No. 5:20-cv-04038-EFM-KGG (D. Kan.)
 - Motion to dismiss granted federal court in Kansas.
 - Variation on themes in *Ogles*.
 - Now on appeal 10th Circuit.
 - Clarity of disclosures challenged
 - Illustrations attacked
- Civil Rico theory re sales practices.



Recent Attacks On Index Universal Life Products

- Allegations of classwide illustration fraud
- Alleged improper marketing of IULs as retirement savings modules
- Alleged incomplete or misleading disclosures
- ***Li v. Pacific Life***, No. 30-2020-01153426-CU-BT-CXC – filed September 2020 in Orange County Superior Court, California
- ***Ciofoletti V. Securian Fin. Grp.***, No. 0:18-cv-03025-JNE-ECW (D. Minn.) – filed in federal court in St. Paul, Minnesota
 - General attack on IUL sales practices
 - Real focus on agents steering their clients to an illegal Ponzi scheme



QUESTIONS?