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Eighth Circuit Affirms Dismissal of RICO Claim in So-Called Shadow Insurance Suit

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In *Ludwick v. Harbinger Group*, the U.S. Court of Appeals for the Eighth Circuit affirmed the dismissal under the McCarran-Ferguson Act of a federal RICO claim against Fidelity & Guaranty (and its owner and several affiliates) alleging that F&G had engaged in statutory accounting fraud to create a false impression of capital adequacy. The crux of Ludwick's claim was that F&G hid its true financial condition by transferring billions of dollars in liabilities to affiliated reinsurers that did not have sufficient covering assets. According to the complaint, as a result of these transactions, had F&G followed Statutory Accounting Principles promulgated by the NAIC, it would have had to report negative, not positive, capital surplus. Ludwick alleged that she bought her F&G annuity based in part on F&G's apparent financial condition and thus overpaid for the annuity. Ludwick appealed the district court's dismissal of her claims on the ground that they were reverse-preempted by the McCarran-Ferguson Act, which provides in relevant part that "[n]o act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance…." On appeal, the Eighth Circuit addressed only whether the RICO claims would "impair" state insurance regulation under the Act. The court of appeals easily concluded that allowing Ludwick's RICO claims to proceed would disrupt state insurance regulation, initially remarking that "[q]uestions about insurance companies' solvency are, no surprise, squarely within the regulatory oversight by state insurance departments." The court found that Ludwick's claims sought adjudication of the same issues vested to the regulation of the insurance departments with oversight of F&G's conduct and financial condition. Specifically, the court observed that reinsurance transactions with affiliates must be submitted to and approved by state insurance regulators, who are directed to consider whether those transactions adversely affect policy owners and leave the insurer with adequate assets and surplus. Litigating Ludwick's claims would require second-guessing the insurance departments' approvals of the reinsurance transactions at issue in the lawsuit. The Eighth Circuit rejected Ludwick's arguments for avoiding application of the McCarran-Ferguson Act. First, the court rejected Ludwick's attempt to reformulate her claims as

challenges to F&G's accounting practices and disclosures, rather than the legitimacy and financial impact of the transactions themselves. The court reasoned that "[t]o decide whether F&G's reported financials reflected a significant departure from the accounting principles it claimed to have followed, a federal court would need to ask what the result of the transactions should have been under those principles." This inquiry would require second-guessing the regulators' oversight and determinations. The court also rejected Ludwick's argument that her claims could proceed against the non-insurer defendants, noting that pursuing the same allegations against the non-insurer defendants would be equally disruptive of state insurance regulation. Finally, the Eighth Circuit disagreed with the district court's reasoning that the absence of a private right of action under the insurance statutes was "dispositive" of whether the suit would impair state insurance regulation. However, given that Ludwick had not demonstrated "that the specific sort of misconduct that she alleges—an insurer lying about its financial condition and accounting—would be actionable under the common law of each implicated jurisdiction," there was no basis for inferring that the states would allow it to proceed, even if those states generally permitted fraudulent inducement claims against insurance companies. The decision signals the end of a brief wave of policy owner lawsuits spurred by a 2012 New York Department of Financial Services' report alleging that insurers were using so-called "shadow insurance" transactions with affiliated reinsurers to misrepresent the adequacy of their capital positions. However, similar "shadow insurance" allegations are being pursued in a few cost of insurance lawsuits pending in the federal courts, where they have not been subject to attack on McCarran Ferguson Act grounds.

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