Defendants Fend Off Challenge to FIA's Proprietary Index

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The End or the Beginning for Suits Over Disappointed Index Interest Expectations?
Security Benefit Life Insurance Co. and Guggenheim Partners recently secured an important victory in a class action challenging a fixed index annuity's proprietary index with a volatility overlay. Various proprietary indexes are being used by the index crediting options of numerous fixed index annuities. A proprietary index provides an alternative to the S&P 500® index by incorporating different asset classes and volatility control mechanisms. The volatility control mechanism shifts between the different assets or asset classes depending on a target level of volatility of the assets or asset classes.

In *Ogles v. Security Benefit Life Insurance Co.*, the plaintiff brought a putative class action against Security Benefit and Guggenheim alleging federal racketeering violations, and a state law claim for unjust enrichment, relating to his purchase of Security Benefit's "Total Value Annuity" (TVA). The TVA contained several interest crediting options based on a traditional index, like an S&P 500 index, as well as a nontraditional index based on commodities and currencies futures coupled with a volatility overlay, known as the Annuity Linked Trader Vic Index (ALTVI). This particular index is generally thought to perform inversely to equities-based indexes, like the S&P 500. Accordingly, if the S&P 500 decreased, the ALTVI was intended to increase and vice versa, thus providing the opportunity for interest credits in times when index crediting options linked to stocks or bonds might not.

In July 2012, the plaintiff purchased the TVA and allocated 100 percent of his premium to the ALTVI-based interest crediting option, which promised interest credits based on the amount of change in the ALTVI at the end of a five-year period. When the plaintiff did not receive any interest credit, he sued, asserting violations of the Racketeer Influenced and Corrupt Organizations Act and alleging misrepresentations to the putative class about Security Benefit's true financial condition and the true nature, development, and potential of the TVA and the performance of the ALTVI.

Under the first of two theories of RICO violations, the plaintiff alleged that certain financial transactions involving Guggenheim, Security Benefit, and other related entities misled him about

Security Benefit's true financial strength and that he would not have purchased the annuity had he known that Security Benefit's financial picture was more tenuous than it appeared. The court, however, determined that this theory was reverse-preempted under the McCarran-Ferguson Act. As the court explained, McCarran-Ferguson bars application of a federal statute if:

1. The federal statute does not specifically relate to the business of insurance;
2. A state statute exists that regulates the business of insurance; and
3. Application of the federal statute would invalidate, impair, or supersede the state statute.

Because the parties agreed that RICO does not specifically relate to the business of insurance and that the relevant states have enacted laws to regulate insurance, the only question was whether the application of RICO would impair those state insurance laws in this context. The court noted that plaintiff's claims regarding Security Benefit's strength, financial transactions, and solvency are matters squarely within the regulatory oversight of state insurance departments. Thus, asking the court to decide the plaintiff's RICO claim based on these financial transactions, which had not been questioned by state regulators, would mean asking the same questions as the state insurance regulators, effectively "double-checking" their work. The court explained that this would improperly interfere with the states' administrative regimes.

The plaintiff's second RICO theory challenged "simulated historical" illustrations of the ALTVI-based crediting option that the plaintiff had received, as well as the ALTVI's design. The plaintiff alleged that the illustrations fraudulently misrepresented the annuity's potential upside and bore no resemblance to actual real world performance. The plaintiff also alleged that the ALTVI itself was designed to underperform and that the volatility overlay was falsely represented to provide more upside potential when in reality it:

1. Was designed to minimize interest credits;
2. Was faulty by design; or
3. Was being improperly managed.

The court, however, held that the plaintiff's attempt to establish predicate RICO acts based on fraud was not supported by any well-pleaded factual allegations. Indeed, the court noted that there was no allegation that the ALTVI-based crediting option's historical simulations were themselves inherently fraudulent — only that the product did not perform as well in the real world. The court also explained that there could be no misrepresentation under the circumstances, because the historical simulations themselves disclosed that "simulated past performance" of the ALTVI "does not reflect what will happen in the future." Similarly, the court held that there were no plausible factual allegations demonstrating that the development of the ALTVI, including the volatility overlay, was somehow fraudulent, let alone that it was designed to underperform. The court concluded that it was hard-pressed to find any misrepresentations, let alone any particularized allegations that would satisfy the heightened pleading requirements, necessary to support a plausible RICO claim.

After dismissing the plaintiff's federal RICO claims for failure to state a claim, the court declined to exercise supplemental jurisdiction over the state law unjust enrichment claim.

The plaintiff recently appealed the dismissal order to the U.S. Court of Appeals for the Tenth Circuit. We will be following this issue closely and will provide continued updates as they become available.

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