New Wave of COI Rate Increase Lawsuits Hits the Industry

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Historically, increases to cost of insurance (COI) rates on universal life (UL) policies have been met with legal challenges from policyholders, and sometimes, regulatory opposition spurred by policyholder complaints. The most common refrain is that, on top of the contract's guaranteed maximum rates, express or implied contractual limitations serve as a check on discretion, prohibiting the insurer from considering factors other than mortality experience. While there have been multiple waves of such litigation, these suits have had mixed outcomes. Judicial rulings are not always easily reconciled as to contract interpretation issues. However, recent developments have led to a potentially more favorable environment for insurers. For example, many insurers have, over time, developed contracts that more explicitly reserve discretion to consider a variety of financial and actuarial factors in setting and changing COI rates. Also, in the last few years, courts have issued several decisions favorable to the insurer on key contract interpretation issues. Against this backdrop, multiple insurers that experienced changes in future expectations as to pricing assumptions announced COI rate increases in the latter half of 2015 on blocks of their UL policies. Not surprisingly, given the litigious history surrounding such rate increases, in the first half of 2016 – following prominent press coverage and intense lobbying of state regulators by life settlement industry participants and consumer groups – at least eight lawsuits challenging such rate increases have been filed. Putative class action suits filed against AXA Equitable and Banner Life Insurance Company help illustrate the plaintiffs' different approaches, and highlight the issues— some familiar, some new—with which the parties and courts will likely grapple for years to come. The two complaints filed against AXA represent a relatively recent phenomenon: COI rate challenges by life settlement investors. In both *Brach Family Foundation* and *Cartolano*, brought in federal courts in New York and Florida, respectively, the plaintiffs allege that AXA's COI rate increases were "unlawful," partly because they allegedly target owners who minimize their premium payments. Both actions incorporate the life settlement industry's myopic view of the flexible nature of UL policies: that they allow policyholders to minimally fund their policies and keep policy values low. Generally, however, the causes of action asserted in the AXA suits are consistent with those seen in COI rate challenges through the years. Thus, in *Cartolano*, in addition to a breach of contract claim, the complaint asserts a claim for declaratory judgment, and alleges that AXA breached the implied covenant of good faith and fair dealing. In addition to an alleged contractual breach, *Brach* advances

a misrepresentation theory, claiming that AXA's illustrations were materially misleading in that they relied on overly aggressive pricing assumptions. While misrepresentation theories have been asserted in other COI suits, the plaintiff's focus on illustrations is novel in this setting. But while the plaintiffs in *Dickman v. Banner*, filed in federal court in Maryland, assert causes of action that are relatively common in COI suits (breach of contract, unjust enrichment, conversion, and fraud), the suit also has more unfamiliar elements. First, plaintiffs attempt to tie their COI rate increase challenge to captive reinsurance – or so-called "shadow insurance"– transactions, claiming that both evince an attempt to "take U.S. policyholder funds and send them to [Banner's parent], ultimately to benefit shareholders." Thus plaintiffs characterize the COI rate increase as a "raid" on policyholder account values. These shadow insurance allegations are seemingly unrelated to plaintiffs' claims or damages, however. Rather, their inclusion appears aimed at enhancing the overall appearance of wrongdoing. And unlike the investor plaintiffs suing AXA, who decry the alleged deprivation of their right to minimally fund their contracts, the plaintiffs in *Dickman* allege they sought to pay *excess* premium payments hoping to *build* the policies' cash value, but were "lull[ed]" into continuing these excess payments via, *inter alia*, policyholder communications stating that the policies were performing as marketed. The central battleground for any COI rate increase challenge is the interpretation of the terms of the COI rate provision involved. The AXA policies quoted in the complaint list several factors: "expenses, mortality, policy and contract claims, taxes, investment income, and lapse," as well as the "procedure and standards on file" with the insurance department. Banner's policies make no explicit reference to any factors – neither setting forth one, like mortality, or a laundry list; rather, they simply state that COI rates will be "based on our expectation as to future experience." Thus, both AXA's and Banner's contracts appear to provide the insurers with discretion to consider factors other than mortality in setting and modifying COI rates – which should demand more creative arguments by the plaintiff's counsel for implying limitations on the insurer's discretion. Yet the *Cartolano* and *Brach* plaintiffs follow the usual path of plaintiffs in COI cases in contesting that AXA's increases were validly based on such factors as mortality or investment income. For example, plaintiffs rely on general mortality statistics to argue that mortality had actually *improved*, hoping to undermine the validity of AXA's own mortality expectations that the opposite would occur. The *Dickman* plaintiffs, facing a broad "expectation[s] as to future experience" clause, seek to cast Banner's asserted changed expectations as, essentially, a "bait and switch." They contended that the pessimistic expectations were concealed for years with overly optimistic pronouncements as to future experience expectations, which in turn acted as a kind of fraudulent inducement to policyholders to purchase the policies and pay their excess premiums. The contracts at issue in the AXA and Banner lawsuits, respectively, also contain clauses prohibiting unfair discrimination among policyholders in the same class, and provide that the rates will "apply to all persons of the same class." While no such challenge is directed to Banner, the AXA suits allege that the insurer improperly determined a "class" based on funding level in order to target policyholders who minimally funded their policies for a COI increase. The *Brach* complaint doubles down on this contention, implicating the nondiscrimination provision, as well as the contract's "standards on file" provision. According to the plaintiff, the principle of nondiscrimination is a "standard on file" with the

insurance departments of New York and other states. AXA moved to dismiss the amended complaints in *Brach* and *Cartolano*, and Banner moved to dismiss *Dickman*. Among other things, these challenges to the sufficiency of the complaints could test the influence of recent rulings favorable to the industry. For example, *Brach* is pending in a forum that already decided an insurer may base COI rate increases on policy funding levels under a contract's "investment earnings" factor because policy values "are a logical thing to consider when predicting expected investment earnings" (*Fleisher v. Phoenix Life Ins. Co.*).* *Carlton Fields represented the insurer in this matter.

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