LIFE, ANNUITY, AND RETIREMENT SOLUTIONS INDUSTRY

Volume I, March 2019

EXPECTFOCUS®

LEGAL ISSUES AND DEVELOPMENTS FROM CARLTON FIELDS

SPEEDING AHEAD:

NEW LEGAL CHALLENGES IN A TRANSFORMING LEGAL LANDSCAPE

CARLTON FIELDS

EXPECTFOCUS®
LIFE, ANNUITY, AND RETIREMENT SOLUTIONS, VOLUME I, MARCH 2019

EXPECTFOCUS® is a quarterly review of developments in the insurance and financial services industry, provided on a complimentary basis to clients and friends of Carlton Fields.

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NAIC Illustration Regulation Races Index Product Innovation

BY ANN BLACK AND TOM LAUERMAN

As index universal life (IUL) and index annuity product innovation sprints ahead, regulators, running to catch up, are considering whether changes are needed to the NAIC's Actuarial Guideline 49 and to its Annuity Disclosure Model Regulation.

Many new index universal life products apply a "multiplier" in computing the index-based interest credits for additional implicit or explicit contract charges. The additional contract charges provide insurers additional funds to support the additional index-based interest credits. Many index annuities include accounts that base index-based interest credits on recently created algorithmic-based indices that include volatility-control features. The algorithmic-based indices may be based on previously existing indices, such as the S&P 500® Index, or on a composite of a variety of indices, a variety of equities within an index, or a variety of asset classes.

Under AG 49, IUL illustrations typically reflect a constant interest rate and do not reflect the actual variability in index-based interest. This variability in index-based interest has a more pronounced impact on IULs with multipliers and may trip up consumer understanding of the potential consequences of the multipliers and the additional charges. AG 49 also caps the index-based interest by limiting the assumed earned interest on the general account assets supporting the IUL, and the AG 49 cap is often below the actual index account caps. This approach was taken instead of including a "hard ceiling" on the interest rate that could be illustrated. To get out of the blocks, the NAIC's Life Acturial (A) Task Force IUL Illustration Subgroup sought comment on eight questions.

The Annuity Disclosure Model Regulation permits illustration only of index accounts based upon indices that have been in existence for at least 10 years. After a false start in which regulators apparently did not like industry's proposed changes, the Annuity Disclosure Model Working Group is receiving comments on a proposal to allow illustration of index accounts based upon an algorithm-based index if:

- The algorithm-based index is based upon other indices that have been in existence for at least 20 calendar years;
- At least 20 years of history can be constructed; and
- The algorithm is fixed from the creation of the index.

During recent IUL Illustration SG and Annuity Disclosure WG calls, comments were made about the possibility of harmonizing the illustration requirements for IULs and index annuities. The work on index product illustrations looks to be a marathon that is just beginning. ■

SEC Open to Modern Communications by Advisers

BY TOM LAUERMAN

The increasingly widespread use and acceptance of various types of online communications have made it more attractive — for both firms and clients — to conduct business online, while at the same time making it more doubtful that all advisory personnel can be relied upon to observe all firm prohibitions on such conduct. In response, the SEC's Office of Compliance Inspections and Examinations (OCIE) published a December 14, 2018, "Risk Alert" that may well accelerate the trend for firms to permit their advisory personnel to use a broad range of electronic business communications.

The Risk Alert addresses, for example, text/SMS messaging, instant messaging, and personal or private messaging used by advisory personnel for business purposes. In general, the Risk Alert covers such "Electronic Messaging" regardless of whether systems or applications ("apps") of the firm or a third party are being used and regardless of who owns the computers or mobile devices being used. However, the Risk Alert does not cover emails using an advisory firm's systems, as OCIE believes that firms already have considerable experience in administering compliance arrangements for those transactions.

Although the Risk Alert by its terms applies only to investment advisers, many of the ideas expressed apply equally to Electronic Messaging by registered representatives of broker-dealer firms, including those who offer insurance products. *See* "FINRA Issues New Guidance on Social Media and Digital Communications," *Expect Focus Life Insurance*, Vol. II (June 2017).

The Risk Alert suggests a number of steps that firms may consider to promote regulatory compliance, including:

- requiring advisory personnel who receive communications in a form prohibited by the firm to move those communications to an electronic system that the firm permits and providing "specific instructions" to such personnel on "how to do so";
- conducting regular internet searches and "regularly reviewing popular social media sites to identify if employees are using the media in a way not permitted" by the firm; and
- establishing confidential means by which advisory personnel "can report concerns about a colleague's electronic messaging, website, or use of social media for business communications."

Although the Risk Alert does not mandate these particular procedures, OCIE probably will be expecting firms to observe compliance procedures that are reasonably designed, in light of the firms' own circumstances, to ensure that advisory personnel are complying with any prohibitions the firm imposes on particular types of communications.

Just Say No?

To the extent that advisers, therefore, may be faced with administering increasingly cumbersome procedures in connection with prohibitions, just saying "no" can become a more costly and unattractive option.

The Risk Alert does, however, suggest that firms consider prohibiting:

- any forms of Electronic Messaging that the firm has not determined can be used in compliance with the books and records requirements under the Investment Advisers Act; or
- any "apps or other technologies that can be readily misused by allowing an employee to send messages or otherwise communicate anonymously, allowing for automatic destruction of messages, or prohibiting third-party viewing or back-up."

How to Say "Yes"

The Risk Alert also may encourage broader use of Electronic Messaging by suggesting a number of procedures that can help firms comply with regulatory requirements. In this connection, OCIE notes:

> "[Some] advisers that permit use of social media, personal email, or personal websites for business purposes [contract] with software vendors to (1) monitor the social media posts, emails, or websites, (2) archive such business communications to ensure compliance with record retention rules, and (3) ensure that they have the capability to identify any changes to content and compare postings to a lexicon of key words and phrases."

Although adequate vendor-supplied services currently may not be available or practical in many circumstances, the number and capabilities of such vendors are expanding.

The Risk Alert also suggests other possible procedures for training and supervision of advisory personnel in their use of Electronic Messaging, including requiring advisory personnel to obtain prior approval and load certain security apps, software, or virtual private networks before accessing firm email servers or other business applications from personal devices.

Reading Between the Lines

Of course, investment advisory firms — and also broker-dealers — should consider the extent to which the procedures cited in the Risk Alert may be appropriate to the firms' current practices. But perhaps more importantly, the Risk Alert implicitly affirms the industry trend toward expanded uses of Electronic Messaging and signals a non-dogmatic and (hopefully) helpful attitude by the SEC staff in policing compliance in this area. ■

Game Changing Fund of Fund Reforms Ahead

BY CHIP LUNDE

On December 19, 2018, the SEC proposed rescinding most so-called fund of funds (FoF) exemptive orders and Rule 12d1-2 under the Investment Company Act of 1940 (Act) and replacing them with new Rule 12d1-4.[1]

Some of these reforms may have significant consequences for both fund complexes that offer FoFs and issuers of variable insurance products that include FoFs as investment options. The deadline for comments on the proposal is May 2, 2019.

Proposed Rule 12d1-4

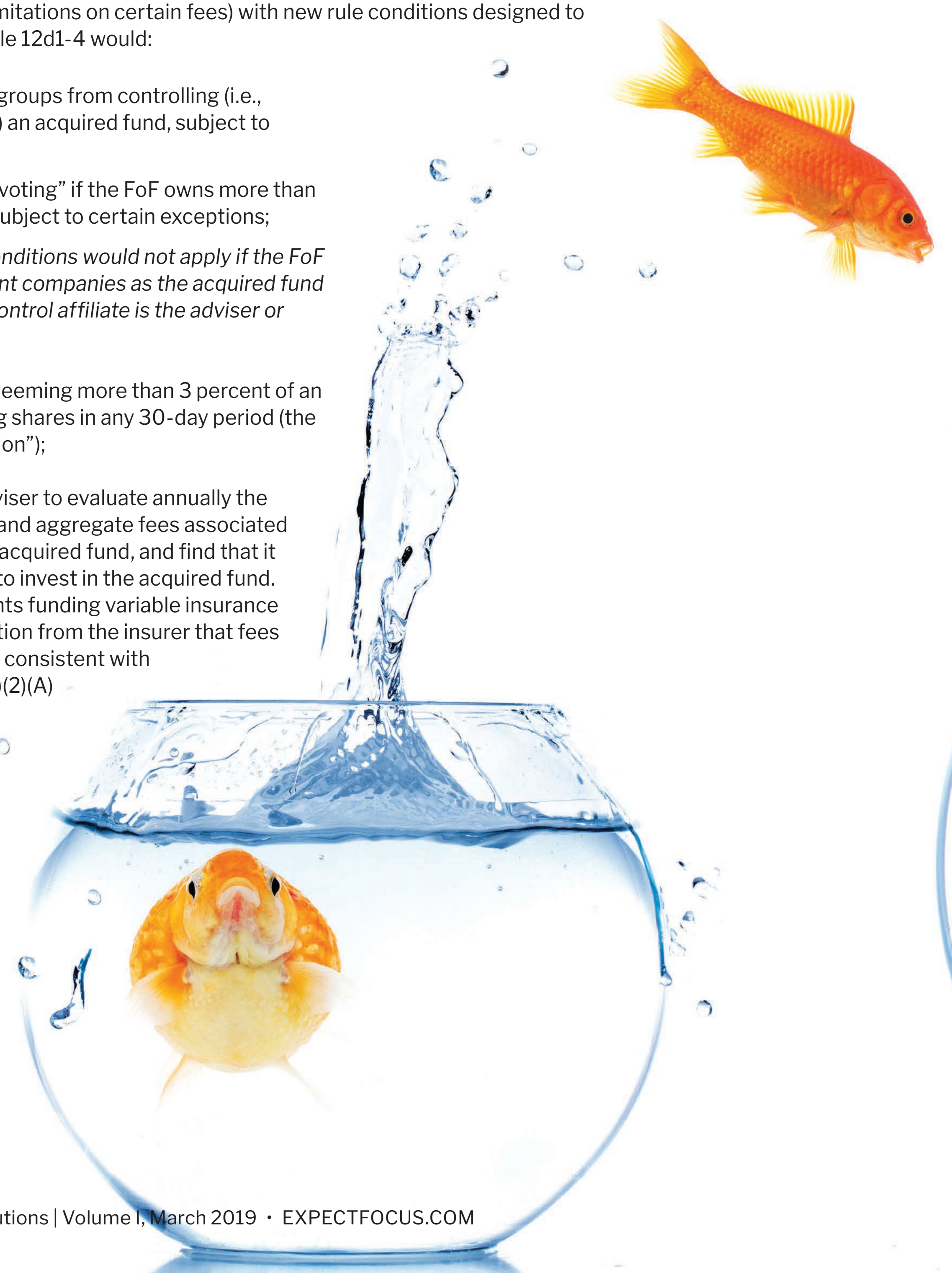
Proposed Rule 12d1-4 would replace the traditional FoF order conditions (such as Board oversight to prevent "undue influence" and limitations on certain fees) with new rule conditions designed to address these issues. Generally, Rule 12d1-4 would:

- prohibit FoFs and their advisory groups from controlling (i.e., owning more than 25 percent of) an acquired fund, subject to certain exceptions;
- require "pass-through" or "echo voting" if the FoF owns more than 3 percent of the acquired fund, subject to certain exceptions;

  (The above control and voting conditions would not apply if the FoF is in the same group of investment companies as the acquired fund or if the FoF's subadviser or its control affiliate is the adviser or depositor of the acquired fund.)

- generally prohibit a FoF from redeeming more than 3 percent of an acquired fund's total outstanding shares in any 30-day period (the "3 Percent Redemption Restriction");
- require the FoF's investment adviser to evaluate annually the complexity of the FoF structure and aggregate fees associated with the FoF's investment in the acquired fund, and find that it is in the best interest of the FoF to invest in the acquired fund. FoFs that sell to separate accounts funding variable insurance products must obtain a certification from the insurer that fees at all levels, in the aggregate, are consistent with the standard under Section 26(f)(2)(A) of the Act; and
- restrict three-tier fund arrangements (subject to exceptions similar to those contained in existing FoF orders).

Several of these conditions may incentivize or require certain FoFs to change their strategies.



[1] The release also proposes related amendments to Rule 12d1-1 and Form N-CEN.

Challenges Presented by Rule 12d1-4

The SEC's historical FoF orders have not included any conditions similar to the proposed 3 Percent Redemption Restriction. The 3 Percent Redemption Restriction could have a variety of negative market effects. It could, for example:

- **incentivize FoFs to invest in larger funds** to avoid becoming a 3 percent owner of any acquired fund (making it more difficult for smaller funds to survive);
- **disadvantage smaller fund complexes** that may be less able to create FoFs that invest in the same group of funds and avoid Rule 12d1-4; and
- **create a "Hotel California" situation** for any FoF (or FoF complex) that owns 100 percent of an acquired fund (either initially or due to redemptions by other investors). A FoF that owns 100 percent of an acquired fund would never be able to redeem all of its shares.

In addition to the above criticisms, the 3 Percent Redemption Restriction could present unique issues for certain transactions. For example, it could take a FoF many months to liquidate a significant position in an acquired fund. A long redemption period could prevent nimble portfolio management and also could delay proposed transactions such as:

- FoF liquidations;
- FoF mergers; and
- variable insurance product substitutions out of a FoF.

Possible Improvements

The SEC could revise its proposal in ways that might improve the functionality of FoF arrangements. These include:

- retaining Rule 12d1-2 and expanding it to cover other non-security financial instruments;
- eliminating the 3 Percent Redemption Restriction where the FoF's adviser or sub-adviser (or control person thereof) acts as the acquired fund's adviser, sub-adviser, or depositor;
- increasing the percentage threshold for unrestricted redemptions;
- waiving redemption restrictions when a FoF's ownership of an acquired fund in excess of the Act's limits is due to redemptions by other investors; or
- retaining existing FoF orders and allowing FoFs the option to either rely on Rule 12d1-4 or a FoF order. ■

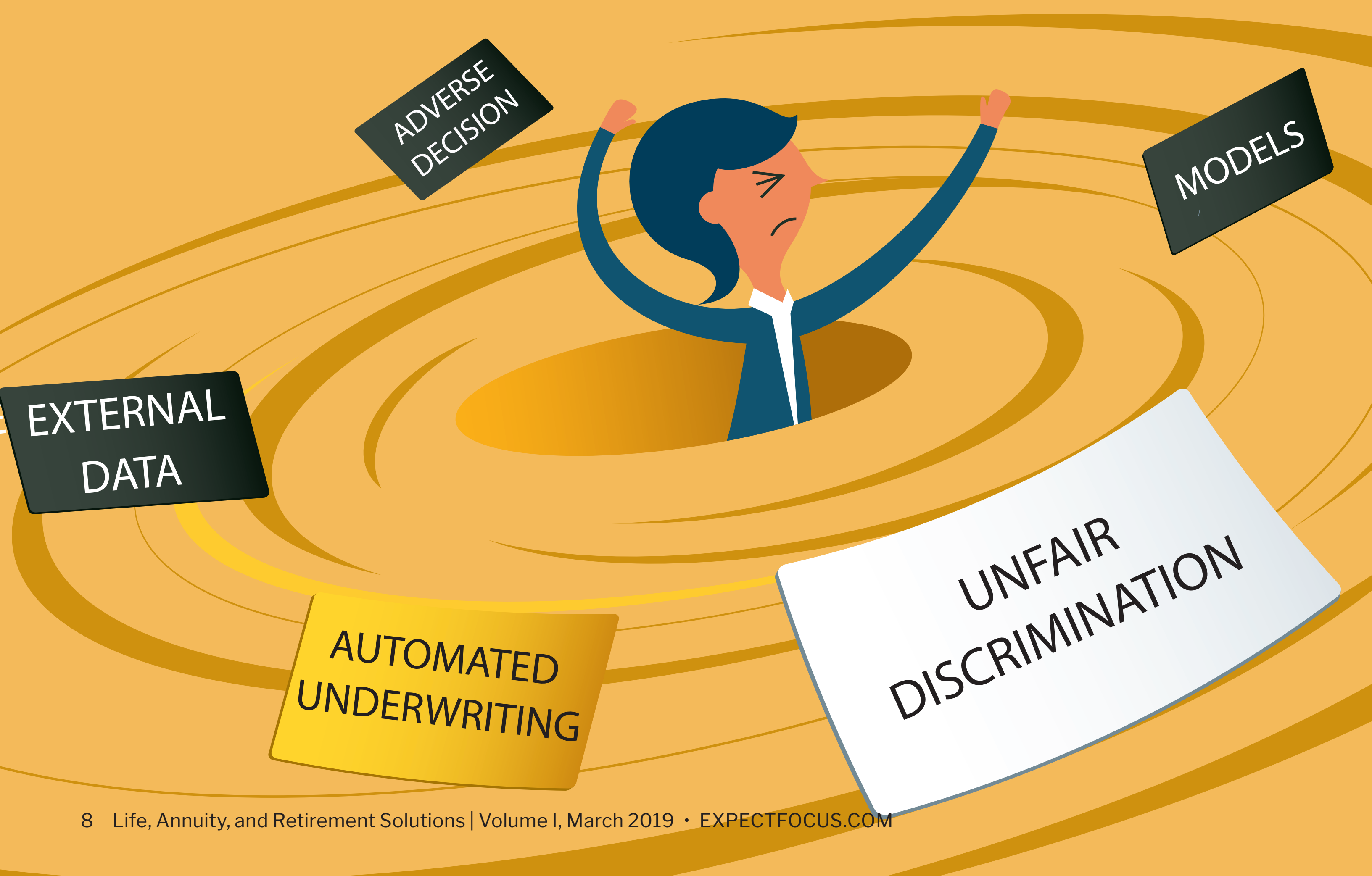
Life Insurers Sinking in Quicksand as Regulators Scrutinize Non-Traditional Consumer Data Sources

BY ANN BLACK AND JAMIE BIGAYER

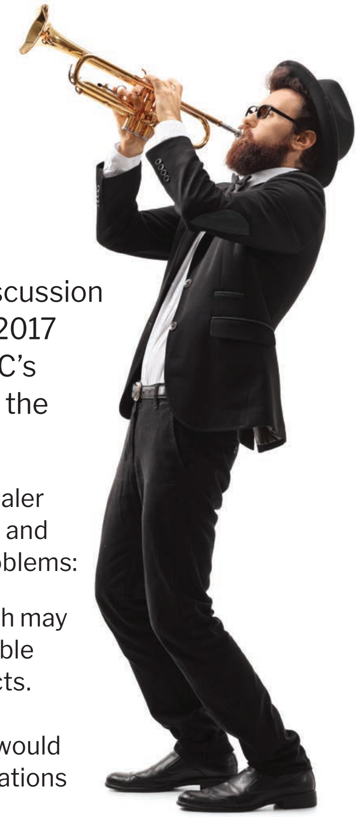
As previously reported in our October 9, 2018, client alert, the sands began shifting in late 2018 when the NAIC Big Data Working Group (Big Data WG) began questioning life insurer's use of big data after a LIMRA survey found that 50 percent of responding life insurers were already using some form of automated underwriting. At the Big Data WG's February 25 meeting, Chair Doug Ommen confirmed the group will continue to focus on the use of big data by life insurers, since "it has become commonplace to use models in life underwriting." Consumer representative Birny Birnbaum suggested that the Big Data WG investigate the potential for unfair discrimination in life underwriting and the use of big data for claims settlement and fraud detection. While the Big Data WG will finalize its 2019 priorities at the NAIC Spring National Meeting, it is clear life insurers will be unable to escape the regulatory sandpit.

And the NAIC is not the only regulator giving life insurers a sinking feeling. As reported in our January 29 client alert, the New York Department of Financial Services (NYDFS) released Circular Letter No. 1 (2019) titled "Use of External Consumer Data and Information Sources in Underwriting for Life Insurance." Letter No. 1 expresses the NYDFS' concerns with the use of external data sources and imposes significant burdens on life insurers using external data and algorithmic underwriting.

There is no end to the quagmire in sight as regulators will continue to examine life insurers' use of non-traditional consumer data sources and algorithmic underwriting, putting life insurer's use on shaky ground. ■



FINRA Trumpets Variable Annuity Sales Problems While SEC Falls Silent



BY GARY COHEN

FINRA's report on its broker-dealer examination findings for 2018 features a substantial discussion of "Unsuitable Variable Annuity Recommendations." This is in sharp contrast with FINRA's 2017 report, which didn't mention variable insurance products at all. It also contrasts with the SEC's Office of Compliance Inspections and Examinations (OCIE) 2019 exam priorities, which, for the first time in some years, does not specify variable insurance products.

FINRA has adopted a practice of annually publishing its observations made in the course of its broker-dealer examinations. One purpose of the report is to help FINRA-member firms refine their compliance policies and procedures. FINRA's most recent report, published last December, addresses a number of perceived problems:

- ***Supervision***. Some firms failed to ensure that reps' recommendations of variable annuities complied with suitability obligations. A number of firms lacked adequate supervisory systems and written supervisory procedures. Other firms had such systems and procedures, but failed to maintain and enforce them.
- ***Exchanges***. Some firms allowed unsuitable and largely unsupervised rep-driven recommendations to exchange variable annuities. Some exchanges were inconsistent with the customer's objectives and time horizon. Other exchanges resulted in increased fees or loss of accrued benefits. These results occurred when reps effected transactions directly with the life insurance company.
- ***Purchase Funds***. Some reps concealed the source of funds used to buy new variable annuities. The reps had customers take direct receipt of monies from existing securities or annuities. This created the appearance of un-invested cash being used for purchase payments. The practice may have resulted in unfavorable tax consequences for the customer.
- ***Training***. Some firms did not adequately train reps selling variable annuities and supervisors overseeing variable annuity transactions. Some reps misrepresented the cost of variable annuity riders through disclosure forms. Other reps lacked knowledge of how to evaluate fees, surrender charges, and long-term income riders, particularly in the context of variable annuity exchanges. Some supervisors appeared to focus on exchange form completion, rather than the substantive factors involved in the customer's decision.
- ***Annuity Data***. Some firms appear to have inaccurate and incomplete data for annuity products. This includes general product information, as well as information on share class, riders, and exchange-based activity.

By contrast, for the first time in some years, OCIE has not listed variable insurance products as an exam priority. Over the last seven years, with the exception of 2015, OCIE has announced that at least variable annuities, if not variable life insurance, have been an exam priority.

OCIE's focus on variable insurance products has shifted over the years. In 2012, the exam priority was "new channels of distribution"; in 2013, "hedge fund investment strategies in variable annuity structures"; and in 2014, insurance company "buybacks." After 2015, OCIE's focus shifted to marketing. In 2016, the focus was on "suitability," and, in 2017 and 2018, "sales."

However, OCIE did state that, in examining broker-dealers and investment advisers, it would focus on "the services and products offered to … those saving for retirement," which may well include variable insurance products.

OCIE said that it would "conduct examinations that review how broker-dealers oversee their interactions with senior investors, including their ability to identify financial exploitation of seniors." OCIE explained that "[t]hese examinations will focus on, among other things, compliance programs of investment advisers, the appropriateness of certain investment recommendations to seniors, and the supervision by firms of their employees and independent representatives."

OCIE gave no reason for omitting specific reference to variable insurance products from its 2019 exam priorities. One possible reason is the perceived emphasis that the Trump administration places on educating, rather than bringing enforcement actions against, industry regarding regulation. Another possible reason is that the life insurance industry has moved into the SEC's regulatory mainstream and no longer requires continuous monitoring of what has been unfamiliar to the agency for so many years.

Still another possibility is that the SEC, having shifted some broker-dealer examiners to investment adviser inspections, will be relying more on FINRA to address variable annuities during its broker-dealer examinations. ■

FINRA Unlocks Some Pre-Inception Index Marketing Data

BY EDMUND ZAHAREWICZ

In January, FINRA issued an interpretative letter allowing member firms to use pre-inception index performance (PIP) data in communications concerning open-end investment companies that are distributed solely to institutional investors. FINRA issued similar guidance in 2013 regarding the use of such data in communications concerning exchange-traded products such as exchange-traded funds.

PIP data model the performance of an index assuming it had existed prior to its inception. Broker-dealers and investment advisers that are institutional investors can and do use PIP data to evaluate new index fund offerings where the benchmark index was created according to a predefined set of rules that cannot be altered except under certain extraordinary circumstances. Such evaluations can help broker-dealers and advisers to decide whether to invest, or recommend that their clients invest, in the offerings.

FINRA's guidance is subject to a lengthy set of conditions designed to prevent the dissemination of PIP data to retail investors and to ensure that any member communications containing PIP data comply with FINRA rules governing institutional communications. Those rules require, among other things, the communications to be fair and balanced and to provide a sound basis for evaluating the facts in regard to the security at issue.

The guidance may be helpful to insurers and distributors in the marketing and development of insurance-dedicated index funds and index-linked or other innovative insurance products.

Read Your Policy Carefully:

UL Policy's Plain Language Requires Dismissal of Putative Class Action Challenging Increased Premiums and COI Rates

BY STEPHANIE FICHERA

The Southern District of Indiana recently dismissed a putative class action alleging that the defendant-insurer improperly inflated premiums and cost of insurance (COI) rates on universal life policies.

In *Couch v. Wilco Life Insurance Co.*, the plaintiff's universal life insurance policy, purchased in 1987 from a predecessor of Wilco Life Insurance Co., included a monthly planned premium of $81. Steadily, Wilco increased the plaintiff's premium to more than $270 per month, which Wilco assessed directly from the policy's cash value. But the plaintiff failed to maintain sufficient cash value, causing the policy to lapse. The plaintiff then filed suit for breach of contract and declaratory judgment, asserting, among other claims, that Wilco improperly increased his premiums and used impermissible factors in determining COI rates. Wilco moved to dismiss, arguing that the policy clearly explained that premiums and COI rates could increase over time.

In dismissing the plaintiff's breach-of-contract claim, the court determined that Wilco could charge more than the $81 planned premium; the policy's plain language stated that the premium required to keep the policy in force might increase, given rising COI rates, which naturally increased as the plaintiff aged.

Similarly, the court found that Wilco could consider factors other than those tied to an insured's mortality when setting COI rates, as the policy provided only two limitations on Wilco's determination of COI rates:

1. that the rates not exceed those set forth in the policy's table of guaranteed rates; and

2. that any change in COI rates would apply uniformly to similarly situated policyholders.

The plaintiff did not contend Wilco breached either of those requirements. The court distinguished cases involving COI provisions that included "based on" or "depend on" language, but it determined that even if the policy included such language, the Seventh Circuit's decisions in *Thao v. Midland National Life Insurance Co.* and *Norem v. Lincoln Benefit Life Co.* would require dismissal of a claim that Wilco could consider only those factors listed in his policy when setting COI rates.

Finally, the court exercised its discretion to dismiss the plaintiff's declaratory-relief claim, finding that the plaintiff's request for declarations regarding the COI rates was duplicative of the dismissed breach-of-contract claims. Because the policy's unambiguous language precluded the plaintiff's claims, the court ultimately dismissed the case with prejudice. ▪

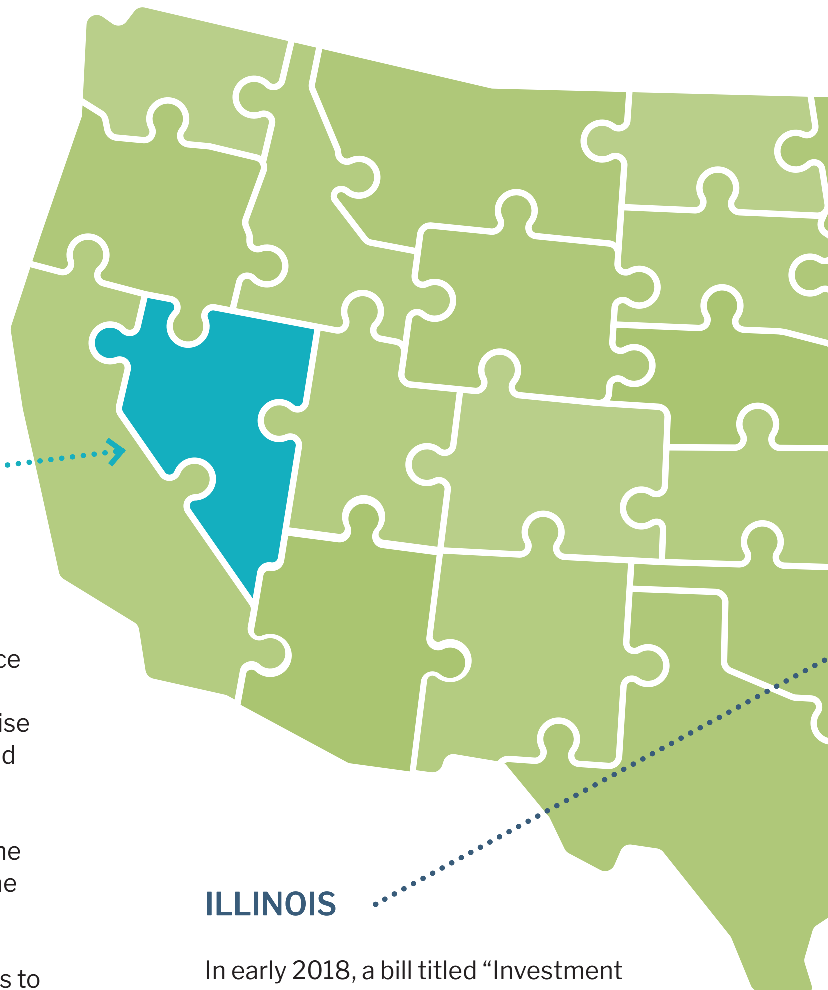
Financial Products: States Continue to Puzzle Together Standards and Required Disclosures for Professionals Selling or Providing Advice

BY ANN BLACK, ADRIANA PEREZ AND STEPHEN CHOI

States continue to puzzle together the duty of care financial professionals owe, or disclosures financial professionals make, to consumers. Ideally, states would ensure that the pieces fit together. However, as reflected in the summary below, states continue to take differing approaches, resulting in pieces being jammed together.

NAIC

The November 19, 2018, draft of proposed revisions to the Suitability in Annuity Transactions Model Regulation (#275) was exposed for comments. While the November 19 draft did not include a best-interest standard, it noted that additional consideration was needed as to the legal distinction between a best-interest standard and a fiduciary standard. The goal of exposing the November 19 draft was to create a working NAIC draft to promote discussions with the SEC and other regulators. While the NAIC sought comments from a broader group, the commenters were the usual parties.



NEVADA

In early 2019, the Nevada Securities Division proposed a broad rule that imposes a fiduciary duty on investment advisers and broker-dealers who provide investment advice to clients, manage assets, perform discretionary trading, use certain titles specified in the proposed rule, or otherwise establish a fiduciary relationship with clients. The proposed rule also outlines the time periods during which broker-dealers or investment advisers are subject to a fiduciary duty standard. Industry trade groups have asserted that the application of the proposed rule is overly broad and that the exemptions are too narrow.

Nevada's Division of Insurance (NVDOI) proposed revisions to Nevada's suitability regulations to incorporate a best-interest requirement along the lines of an earlier but subsequently abandoned draft of its Suitability and Best Interest Standard of Conduct in Annuity Transactions Model. Commenters urged the NVDOI to drop its efforts and await further action by the NAIC on the Suitability in Annuity Transaction Model.

ILLINOIS

In early 2018, a bill titled "Investment Advisor Disclosure Act" was introduced without any language, and no subsequent action has occurred.

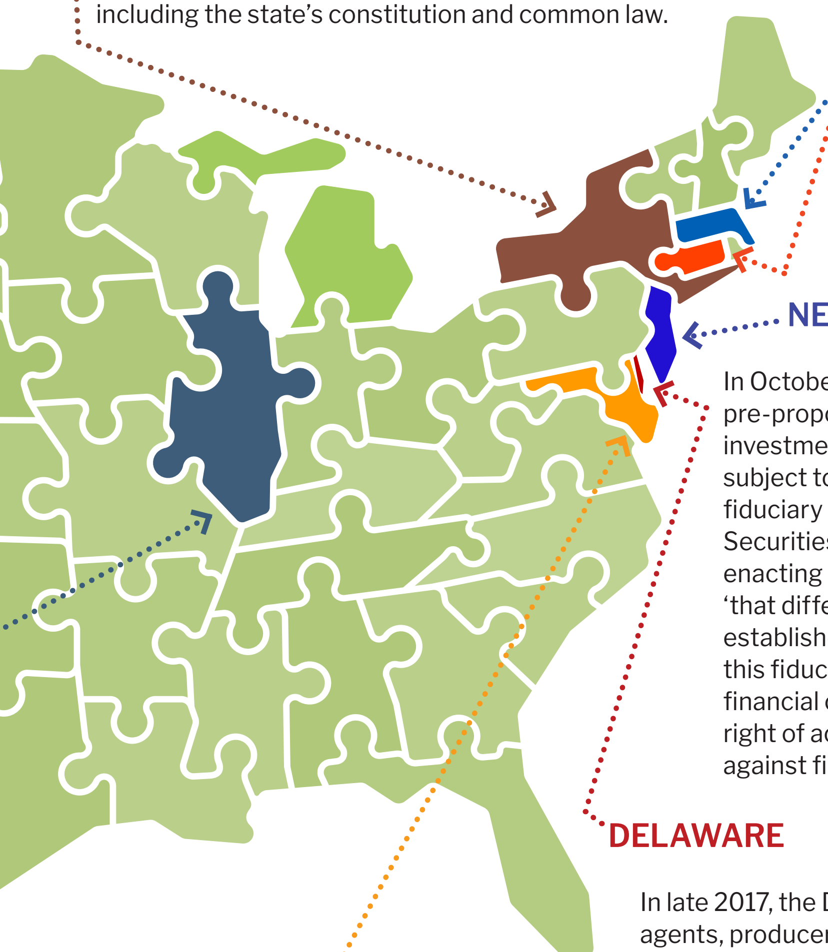
NEW YORK

The First Amendment to Regulation 187 incorporates a best-interest standard and imposes differing duties for recommendations with respect to "new sales" and "in-force transactions" involving life insurance and annuities. Reg 187 will take effect with respect to annuities on August 1, 2019, and with respect to life insurance on February 1, 2020.

Two lawsuits, *In re Independent Insurance Agents & Brokers of New York, Inc.* and *In re National Association of Insurance and Financial Advisors – New York State, Inc.*, have been filed, raising a number of issues challenging the legality of Reg 187 under New York law, including the state's constitution and common law.

MASSACHUSETTS

In his August 2018 comments on the SEC's Reg BI Proposal and Form CRS, William Galvin, Massachusetts' Secretary of the Commonwealth, urged the SEC to adopt a fiduciary standard where "best interest" is defined "as no less stringent than the standard under the '40 Act" and to adopt a private right of action to bring claims for violations of the duty. He also asserted that Reg BI is inadequate to provide consumers protection and "if the Commission does not adopt a strong and uniform fiduciary standard, Massachusetts will be forced to adopt its own fiduciary standard."



CONNECTICUT

Effective July 5, 2017, non-regulated Connecticut financial planners are required to disclose whether they are a fiduciary if asked by a consumer.

NEW JERSEY

In October 2018, the New Jersey Bureau of Securities issued a pre-proposal for comment as to whether broker-dealers, agents, investment advisors, and investment advisor representatives should be subject to a fiduciary duty. Industry groups asserted that any state-level fiduciary duty faces significant preemption hurdles due to the National Securities Markets Improvement Act, which "precludes a State from enacting regulations relating to the making and keeping of records 'that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act].'" Consumer groups argued that this fiduciary standard should apply to all consumers and all forms of financial or investment advice and urged New Jersey to include a private right of action "so that investors can take action on their own behalf against financial professionals and their firms that violate the rule."

DELAWARE

In late 2017, the Delaware Department of Insurance proposed requiring agents, producers, brokers, and companies to complete a written suitability review before the issuance of any life, limited benefit, long-term care, or Medicare supplement policy.

MARYLAND

In February 2019, bills were introduced in the Maryland Senate and House imposing a fiduciary duty on broker-dealers and their agents, insurance producers, investment advisers, federally covered advisers, and investment adviser representatives to act in the best interest of the customer without regard to the financial or other interest of the person or firm providing the advice. Maryland's Securities Commissioner asserted at a public hearing that a level playing field was necessary to erase consumer confusion about the duty of care owed by financial professionals. Industry groups urged the legislature to wait for the SEC to finalize Regulation Best Interest ("Reg BI"), while consumer groups praised Maryland's efforts, commenting that the SEC's Reg BI won't likely become a true fiduciary standard.

Circuit Court Rules Insurance Agents Are Not "Employees" Under ERISA

BY TODD M. FULLER

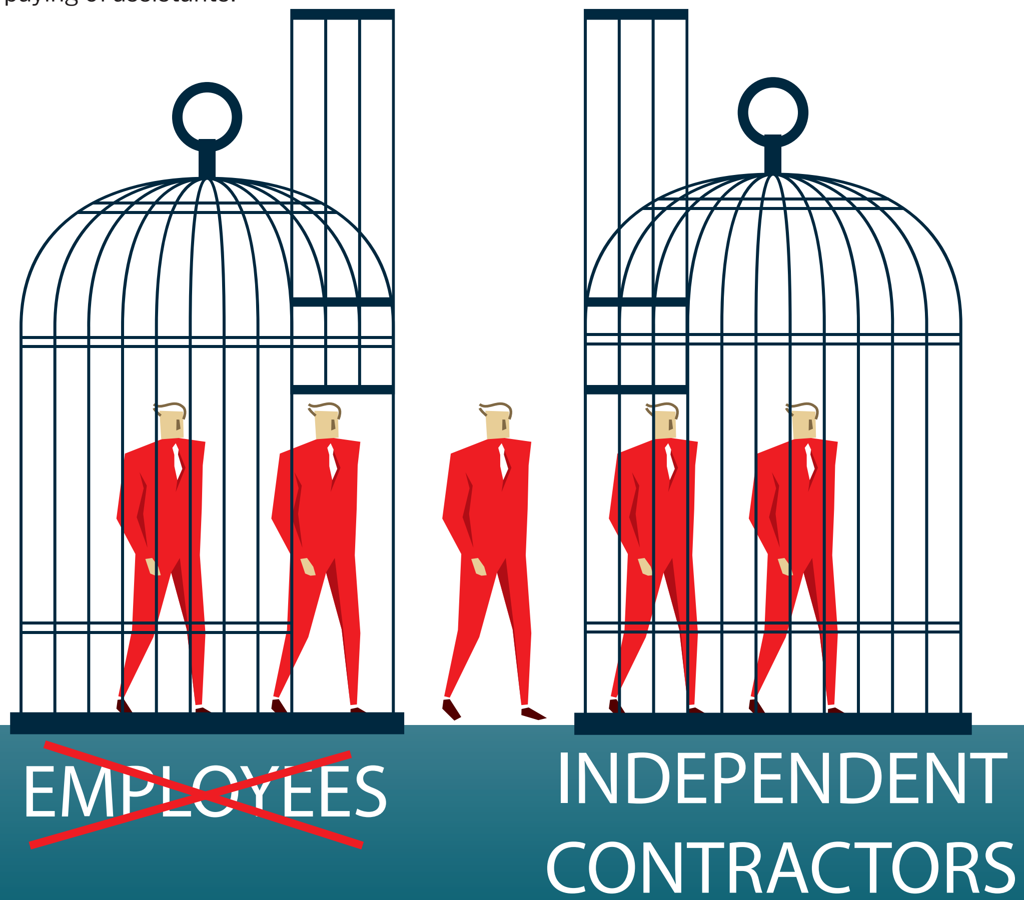
The identity crisis appears to be over for one insurer using independent contractors. In *Jammal v. American Family Insurance Co.*, the Sixth Circuit reversed the district court and held that a putative class of insurance agents for American Family Insurance Co. were properly classified as independent contractors under ERISA and, therefore, not entitled to ERISA benefits. The ruling helped to quell insurance industry uproar resulting from the district court's decision in 2017, much to the dismay of the several thousand current and former American Family agents who had argued the insurer misclassified them as independent contractors to avoid paying them ERISA-required benefits.

The Sixth Circuit's decision turned on its analysis of the *Darden* factors for determining who qualifies as an employee under ERISA, as set forth in the Supreme Court's *Nationwide Mutual Insurance Co. v. Darden* opinion, and the court's review of those factors as conclusions of law rather than fact. The court found that the district court incorrectly applied the standards relating to:

1. the skill required of an agent; and

2. the hiring and paying of assistants.

According to the court, the correct application of the *Darden* standards weighed in favor of independent-contractor status. The Sixth Circuit also found that the district court failed to give sufficient weight to the parties' written agreement, which expressly stated the parties' intent to establish an independent-contractor relationship, and the factors relating to the "*financial structure* of the company-agent relationship," including the source of the instrumentalities and tools, method of payment, provision of employee benefits, and agents' tax treatment. The Sixth Circuit explained that, had the district court "properly weighed those factors in accordance with their significance, it would have determined that the entire mix of *Darden* factors favored independent-contractor status." ■



Life Insurer Permitted to Adjust Policy Proceeds Pursuant to Misstatement-of-Age Provision

BY STEPHANIE FICHERA

In *Jackson National Life Insurance Co. v. Dobbins*, the Fifth Circuit Court of Appeals affirmed the district court's grant of summary judgment for an insurer in an interpleader action, which resolved, among other things, whether the insurer was entitled to reduce the proceeds of a life insurance policy pursuant to the policy's misstatement-of-age provision.

In 1999, the insured purchased a $1 million term life insurance policy from Valley Forge Life Insurance Co. and subsequently named primary and contingent beneficiaries. In 2007, the insured used the policy as collateral for a loan and assigned its proceeds to a bank. When the insured died in 2015, he was in default on the loan, and the FDIC, receiver for the now-closed bank, submitted a claim for the policy's proceeds. The previously named primary and contingent beneficiaries also submitted claims. Valley Forge's successor, Jackson National Life Insurance Co., commenced an interpleader action, seeking permission to deposit the proceeds of the life insurance policy with the court and a decision as to who was entitled to the proceeds. The district court granted Jackson National's interpleader motion, but Jackson National only deposited $910,888.82 — not the full $1 million policy proceeds — with the court, taking the position that Valley Forge had misstated the insured's age in the policy. Jackson National sought a declaration that, pursuant to the policy's misstatement-of-age provision, it could adjust the policy's proceeds amount at any time to represent the actual risk undertaken based on the true age of the insured. The district court granted summary judgment for Jackson National, accepting the reduced amount and declaring that the reduction in the policy's proceeds was in compliance with its terms. The FDIC appealed.

The Fifth Circuit affirmed the district court's decision. Applying Oklahoma law, the court agreed that, by adjusting the proceeds, Jackson National was simply enforcing the plain language of the policy's misstatement-of-age provision. Oklahoma law requires that misstatement-of-age provisions be included in each life insurance policy and recognizes the ability of an insurer, absent contractual language to the contrary, to adjust policy proceeds pursuant to such provisions. The court further rejected the FDIC's argument that Jackson National's action was untimely, noting that neither the policy nor Oklahoma law placed any time limit on when an insurance company may enforce a misstatement-of-age provision. ■

Individual Indexed Annuities Viewed as Installment Contracts for Statute-of-Limitations Purposes

BY BROOKE PATTERSON

In a recent decision by a New Jersey district court partially denying a motion to dismiss, the characterization of individual indexed annuities as installment contracts had a significant impact on the potential liability of the insurer.

In *Angelo v. Fidelity & Guaranty Life Insurance Co.*, the plaintiff invested $120,000 in an annuity with Fidelity's predecessor in 2005, which allocated a portion of the investment to a two-year index option, and another portion to a three-year monthly index option. The plaintiff alleged that he was receiving only one year of interest for each option, rather than interest for each year of the option. The plaintiff sued in state court and asserted claims for breach of contract, unjust enrichment, and consumer fraud. Fidelity removed the action to federal court and subsequently moved to dismiss.

Fidelity argued that the claims were barred by New Jersey's six-year statute of limitations, as the annuity contract was entered into in 2005, and no changes had been made to its terms. Fidelity additionally argued that, if any miscalculations were made, they were made in 2011 when a letter was sent indicating that changes were recorded in connection with the contract. The plaintiff conceded that the six-year statute of limitations applied, but argued that the annuity products were installment contracts, rendering Fidelity liable for some of the alleged interest miscalculations.

The district court determined that the installment-contract approach applied to the annuity contract at issue because it required the payment of interest on a recurring basis. The district court noted that, for installment contracts and contracts including "divisible, installment-type payment requirements," claims begin to run against each installment as it falls due, with a new cause of action arising from the date of each missed payment or underpayment. Because the complaint alleged that Fidelity had failed to pay the interest on a recurring basis, the court held that the obligation was an installment-type payment and that the six-year statute of limitations arose with each alleged underpayment of interest.

The district court then addressed Fidelity's arguments with respect to the claims themselves. The court denied Fidelity's motion to dismiss the breach-of-contract claim, holding that, viewing the facts as the plaintiff had presented them, the complaint adequately stated a claim for breach of contract. The district court noted that the alleged annuity required: (1) the plaintiff to pay his investment, which he did; and (2) Fidelity to pay interest on the annuity options chosen. The court explained that because the complaint alleged that Fidelity failed to pay the proper interest in breach of the annuity contract, it stated a viable breach-of-contract claim.

The district court, however, dismissed the unjust-enrichment claim because an unjust-enrichment claim is not viable when a valid, unrescinded contract governs the rights of the parties. The court noted that because the plaintiff's claim was based on the failure to provide interest under a valid contract, the unjust enrichment claims must fail. The district court likewise dismissed the New Jersey Consumer Fraud Act claim because the complaint simply alleged a breach of contract based on Fidelity's failure to pay the plaintiff his interest on a yearly rate. The district court held that without more there could be no consumer-fraud violation. ■

UCL and Financial Elder Abuse Claims Against Life Insurer Are Time-Barred

BY ENRIQUE ARANA

Life insurers in California are all too familiar with claims based on alleged violations of senior notice statutes and financial elder abuse. In *Rhinehart v. Genworth Life & Annuity Insurance Co.*, a California federal court recently dismissed such a case, holding that the plaintiff's Unfair Competition Law (UCL) and elder abuse claims were barred by the relevant statutes of limitations.

In 2011, the plaintiff, who was 72 years old when he bought the life insurance policy at issue, brought a putative class action in California state court, alleging that the defendant-insurer had violated provisions of the California Insurance Code requiring life insurance companies to provide certain disclosures relating to free look periods and surrender charges on the cover page or policy jacket of policies sold to consumers 60 years of age and older. The complaint asserted claims for unfair business practices under the UCL and financial elder abuse. The putative class consisted of California seniors who had purchased policies from the defendant and sought the return of commissions and profits, including surrender charges, punitive and treble damages for the elder abuse claim, and attorneys' fees.

The defendant removed the action to the Eastern District of California pursuant to the Class Action Fairness Act (CAFA) and moved to dismiss, arguing that the plaintiff's claims were barred by the relevant four-year statute of limitations. The plaintiff sought to remand the case to state court, challenging the defendant's calculation of the $5 million jurisdictional threshold under CAFA. The court, however, determined that the defendant's calculation of potential surrender charges based on the complaint's allegations, and its addition of potential attorneys' fees, which it supported by pointing to the approval of a settlement involving similar claims, satisfied the CAFA threshold. Because the total amount in controversy exceeded $5 million, the court denied the motion to remand.

With respect to the defendant's motion to dismiss, the court determined that the claims were time-barred. Because financial elder abuse claims accrue when an insurance policy is executed and delivered, and because UCL claims accrue at the time of the defendant's alleged misrepresentation or omission, the court held that the claims accrued in 2011 when the plaintiff purchased the policy. In an effort to avoid the limitations period, the plaintiff argued that he did not discover the problems with his policy until after his daughter found old renewal notices and he spoke to an attorney. However, the court held that for the discovery rule to apply, the plaintiff was required to allege facts showing that his failure to discover the relevant facts sooner was reasonable rather than negligent. The court held that the plaintiff had failed to allege any such facts and that the plaintiff's age alone was insufficient to make the required showing. Accordingly, the court dismissed the complaint, but granted the plaintiff a single opportunity to amend. ▪

Building an Ark: Protecting Employee Data in the Data-Breach Era

BY JILL ORTICELLI

Recent years have seen not so much a leak as a flood of data breaches affecting companies nationwide. But the traditional systems devised to safeguard against data breaches won't withstand the vulnerabilities created when information is shared with third-party providers. And although companies are somewhat buoyed by legislation to protect against cyberattacks, companies are often left adrift in a sea of uncertainty as the wave of cybersecurity risks threatens to rise.

As risk levels rise, however, so too does an employer's responsibility to re-evaluate its data security practices. On November 21, 2018, in *Dittman v. UPMC*, the Pennsylvania Supreme Court held that employers have a common-law duty to protect their employees' sensitive personal information stored on an internet-accessible computer.

In *Dittman*, a group of employees filed a class action lawsuit against their employer after a data breach resulted in the theft of sensitive personal information of thousands of employees. The stolen information, which the employees were required to provide as a condition of employment, was stored on the employer's computer systems and ultimately used to file fraudulent tax returns, resulting in damages to the employees. The employees asserted claims of negligence and breach of implied contract, alleging that the employer failed to maintain adequate security measures — including in accordance with industry standards on cybersecurity — to safeguard employees' information.

The trial court dismissed the case, holding that the economic-loss doctrine, as decided in prior appellate rulings, precluded the employees' claims, which asserted solely economic losses. The trial court also declined to impose a new affirmative duty of care to protect data, noting that the financial impact of doing so could put entities out of business. On appeal, the Superior Court upheld the dismissal and held that the trial court properly determined that the employer owed no duty to its employees under Pennsylvania law.

The Pennsylvania Supreme Court reversed the lower courts' decisions, applying an existing duty of care to a novel factual scenario, and held that the employer's affirmative conduct in requiring its employees to provide personal information as a condition of employment gave rise to a duty to exercise reasonable care to safeguard that information. The duty of reasonable care includes a duty to implement reasonable security measures to protect against the foreseeable risk of a data breach, especially considering that an employer's inadequate data collection and storage practices evidently create the risk of a data breach.

Dittman has been touted as a warning to employers — but the decision has ramifications beyond those with an employer-employee relationship. Any service provider hosting or handling employee data should take heed. Therefore, it has become even more imperative that employers address the vulnerabilities created by information sharing with third-party product and service providers. And especially in industries where there is no established regulatory framework outlining specific requirements, *Dittman* is clear: build a better boat. ■

Be Prepared for the Next Wave of Biometric Data Laws:

Five Tips for Businesses

BY JOSEPH SWANSON, STEVEN BLICKENSDERFER AND R. QUINCY BIRD

Advancements in technology have made it possible for more companies to use biometric data to streamline their business, improve security and workplace efficiency, and offer new services and features to customers. Biometric data broadly consists of any information that can be used to identify a person based on biometric identifiers, such as fingerprints, retina scans, and facial geometry. Real-world applications for this type of technology are endless, from smartphones activated by facial recognition, to employee time-management processes that rely on fingerprints in lieu of traditional punch-clock cards.

Although biometric technology offers myriad opportunities to streamline business processes and offer new services, that technology also carries with it increasing regulatory and litigation risk. Congress and state legislatures are considering new laws to regulate the collection and use of personal data, including biometric data. Currently, there is no federal law that regulates the collection and use of biometric data, but its use could implicate existing federal laws, including HIPAA and the Fair Credit Reporting Act, among others. Additionally, it is unknown whether and to what extent the various federal data privacy laws under consideration at the national level would regulate the use of biometric data or preempt state laws. Three states have enacted biometric data privacy laws: Illinois, Texas, and Washington. But the Illinois Biometric Information Privacy Act (BIPA) is the only one to provide for a private right of action, whereas the Texas and Washington statutes are enforced by the state attorneys general.

In *Rosenbach v. Six Flags Entertainment Corp.*, the Illinois Supreme Court held that a plaintiff suing under BIPA need not allege or show actual injury or an adverse effect to maintain an action for damages under the statute. This is important because BIPA allows for $1,000 or $5,000 in statutory damages per violation, depending on whether the violation was negligent, intentional, or reckless. As anticipated, the *Rosenbach* decision has already resulted in a sharp increase in class action lawsuits, many of which have been filed against employers for their use of biometric data in the workplace. Some companies have even altered their behavior as a result of this law. For example, Nest, the maker of smart thermostats and doorbells, reportedly deactivated a feature of its popular doorbells in Illinois, lest that feature draw the ire of plaintiffs' attorneys.

States without biometric information regimes may still regulate under common law or privacy-related statutes, but a handful of other jurisdictions have proposed, or are currently considering, biometric data privacy legislation with varying requirements, including Alaska, Arizona, Connecticut, Delaware, Florida, Massachusetts, Montana, New Hampshire, and New York City. Some of these proposed statutes would include a private right of action like Illinois' BIPA, while others would be enforced by the state's attorney general. The new law introduced in Florida, HB 1153 and SB 1270, is patterned after Illinois' BIPA and, as introduced, would allow for a private right of action. It would not permit businesses to "collect, capture, purchase, receive through trade, or otherwise obtain" biometric data without written notice and consent from the individual.

Given the extraterritorial reach of Illinois' BIPA and the fact that other jurisdictions are likely to enact their own versions of it, companies would be wise to evaluate their practices and policies related to the collection and use of biometric data. Specifically, businesses should undertake the following:

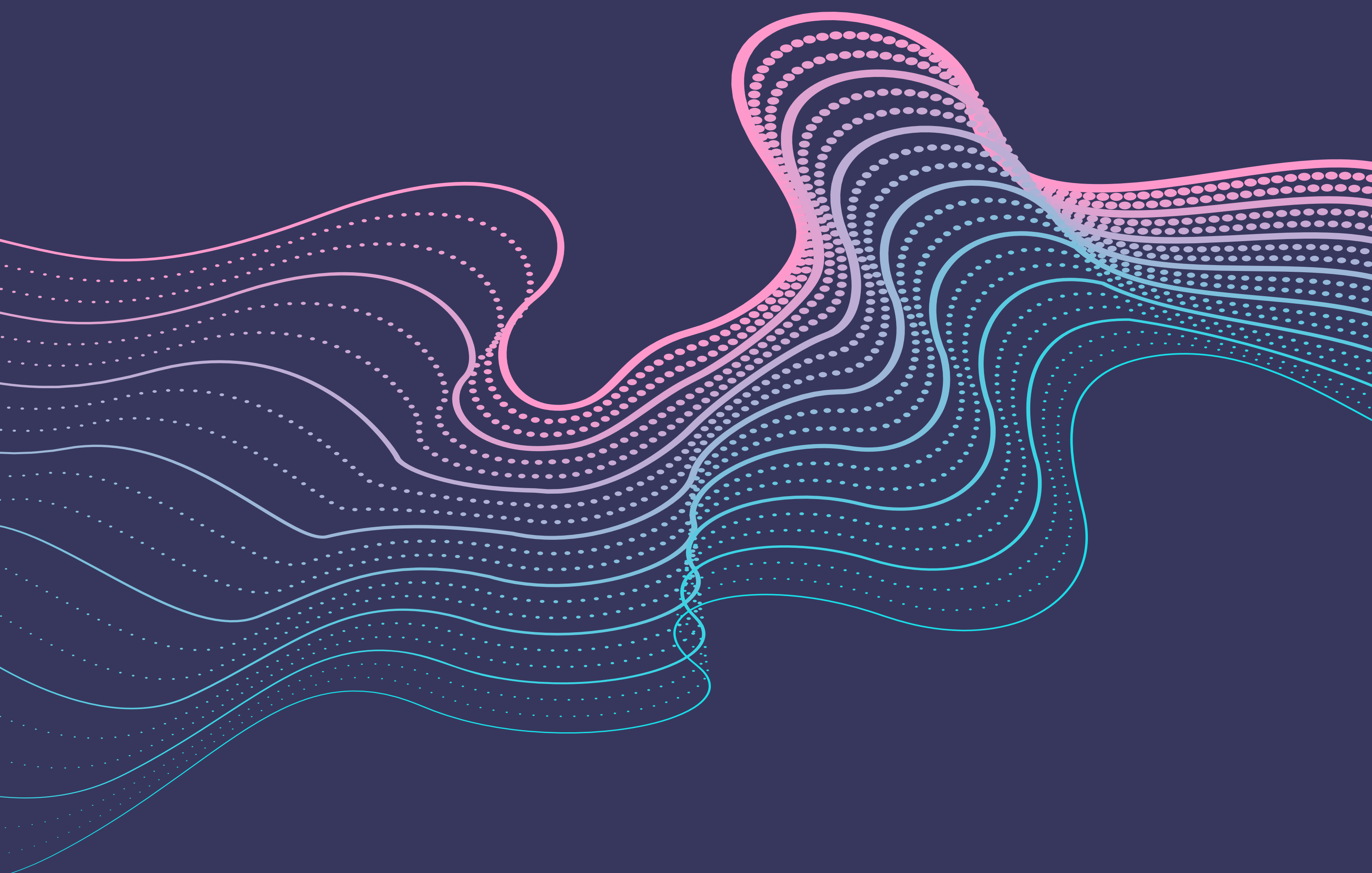
1. Evaluate the extent to which the organization and its vendors collect and use biometric data from its employees and consumers. Review vendor agreements for indemnification and employee training provisions, if applicable.

2. Obtain written and informed consent from the employee or consumer before the collection and use of biometric data, setting forth the specific purpose and length for which the data will be used and held.

3. Develop a written policy to govern the collection and use of biometric data that sets forth the purposes and scope of the collection and use of the data, as well as the means for retaining and deleting the data after its life cycle.

4. Remember to update any outward-facing privacy policies to reflect any personal information being collected or processed as a result of new product lines or ventures, including biometric data.

5. Consider whether it is necessary to update the company's data incident response plan to include biometric data as information that, if exposed, would trigger notice requirements.



NEWS & NOTES

Carlton Fields was recognized in *JD Supra's* 2019 Readers' Choice Awards for visibility and thought leadership in the key, cross-industry topics of insurance and cybersecurity. Firm attorneys **Ann Black** and **Jamie Bigayer** were also acknowledged as top authors.

Carlton Fields is pleased to announce the firm has been named to the 18th Annual BTI Client Service A-Team 2019 report, a designation limited to law firms that deliver unparalleled client service. This is the only law firm ranking that identifies top law firms for client service though a national survey of corporate counsel.

Corporate counsel named Washington, D.C., and Miami Shareholder **Markham Leventhal** a "Client Service All-Star" in BTI Consulting Group's 2019 survey, *BTI Client Service All-Star* list. All-Stars are identified solely through unprompted client feedback that recognizes them for delivering the absolute best client service. According to BTI, a national insurance company named Leventhal to this elite group.

Miami attorney and co-chair of the firm's Blockchain and Digital Currency practice **Justin Wales** was selected as a winner of the *Daily Business Review's* 2019 On the Rise Award, which honors the top South Florida attorneys under the age of 40.

Carlton Fields Director of Legal Project and Practice Management **C. Peter Hitson** recently earned the designation of Accredited Legal Project Manager (ALPM) from the True Value Partnering Institute.

Carlton Fields hosted the second annual American Bar Association Current Issues in FINRA Arbitration and Enforcement CLE program on February 22 in Tampa, Florida. The program covered pertinent topics for those in the securities and financial services industry, such as cybersecurity, FINRA investigations and inquiries, and financial elder abuse. Firm attorneys **Jack Clabby** and **Joe Swanson** participated in the panel on cybersecurity and data safeguarding for broker-dealers and investment advisers.

The firm's Miami office hosted the Dade County Bar Association on December 12 for its Cryptocurrency Panel & Luncheon. Carlton Fields attorney **Justin Wales**, who chairs the firm's blockchain practice, provided insight on the changing legal landscape for cryptocurrency.

The firm is a sponsor of the Global Insurance Symposium, taking place April 23-25 in Des Moines, Iowa. The conference allows insurance and financial services executives to discover cutting edge technologies impacting the industry, network with regulators and leaders in the field, and gain valuable knowledge.

Carlton Fields is sponsoring the Insured Retirement Institute (IRI) ACTION19 conference on May 15-17 in Washington, D.C. The conference is designed to capitalize on the synergies between the retirement income industry's most dynamic thought leaders in the advocacy, legal and compliance community and the operations and technology community.

Carlton Fields has opened an office in Short Hills, New Jersey. The new office, which launched with five commercial and insurance litigators, extends the firm's ongoing growth in the New York area and complements Carlton Fields' expanding National Trial and Insurance practices. The attorneys represent privately held and publicly traded lenders nationwide in multifamily housing and health care facility financings.

The firm has expanded its Washington, D.C., office and Real Estate and Commercial Finance practice with the addition of a group of lawyers who have deep experience in representing public and private mortgage lenders on all Fannie Mae, Freddie Mac, and HUD/FHA financing products. The attorneys represent privately held and publicly traded lenders nationwide in multifamily housing and health care facility financings.

Carlton Fields welcomes the following attorneys to the firm: Shareholders **Gina Hough** (real estate and commercial finance, Washington, D.C.), **Robert Novack** (property & casualty insurance, New Jersey), **Michael Margulies** (property & casualty insurance, New Jersey), **Samantha T. Schneck** (real estate and commercial finance, Washington, D.C.), and **Robert Simpson** (mass tort and product liability, Hartford); Of Counsels **Charles Stotter** (property & casualty insurance, New Jersey) and **J. Coy Stull** (intellectual property, Washington, D.C.); Senior Counsels **Lauren Greenspoon** (mass tort and product liability, Hartford) and **Duy Duc "Dewey" Nguyen** (real estate and commercial finance, Washington, D.C.); Counsel **Marsha Baumgarner** (real estate and commercial finance, Washington, D.C.); Associates **Farah Alkayed** (business litigation, Los Angeles), **Yelena Chan** (real estate and commercial finance, Atlanta), **Austin M. Eason** (health care, Tampa), **Christina Gallo** (property & casualty insurance, New Jersey), **Lauren Giudice** (business litigation, Orlando), **J. Emma Mintz** (property & casualty insurance, New Jersey), **Vincent Weinert-Baumann** (real estate and commercial finance, Washington, D.C.); and Nurse Consultant **Barbara Burke** (Hartford).

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