

Clarity on Application of California Usury Law: Insurers Not Subject to Compound Interest Limitations

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The California Supreme Court recently handed Northwestern Mutual Life Insurance Co. a decisive victory in a putative class action challenging the insurer's assessment of compound interest on policy loans, holding that insurers are not subject to the compound interest limitations of California's usury laws.

Answering a question from the Ninth Circuit Court of Appeals in *Wishnev v. Northwestern Mutual Life Insurance Co.*, the California Supreme Court unanimously ruled that insurers are exempt from a century-old voter initiative, which requires lenders to obtain borrowers' signed consent before compound interest can be charged on loans.

The 1918 voter initiative was designed to provide a uniform approach to the maximum allowable interest rate applicable to all loans and lenders. Among other things, the 1918 initiative provides that interest may not be compounded "unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith." In 1934, the voters amended the California Constitution to address interest rates and exempt certain lenders from these restrictions. As a result, specified lenders, including insurers licensed to do business in the state, were now exempt from the interest rate limitations. The 1934 amendment, however, made no mention of compounding interest. Thus, the question for the California Supreme Court was whether these exempt lenders remained subject to the 1918 initiative's compound interest restrictions.

The court noted that these laws were "far from a model of clarity," and the "interplay among these sources continues to generate confusion." However, after a lengthy discussion of the history of the 1918 initiative, voter-approved constitutional amendments, and various "statutes scattered throughout various codes regulating lenders considered exempt," the court concluded that "the

1934 amendment impliedly repealed the compound interest limitation as to exempt lenders,” like Northwestern Mutual. The court cautioned that “[t]his conclusion does not mean exempt lenders may charge compound interest without a contractual or legal basis to do so,” but “simply means they are not subject to statutory liability and penalties otherwise imposed by the 1918 initiative on nonexempt lenders.”

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