Life and Annuity Series: Significant Litigation Risks

MARCH 29, 2016

WilmerHale Partner Charles Platt, a leading commercial litigator who is recognized nationally for his work defending financial services and insurance companies, periodically drafts legal news alerts for clients about the life and annuity insurance industry. The following alert is the first in the series, with more scheduled to be published in 2016 and beyond.

Insurance companies have confronted significant class action litigation risks on several fronts over the past year. Here are some of the more significant risks presented:

- Annuity investors claim they are subject to “excessive fees,” both under the Investment Company Act of 1940 and under ERISA. The '40 Act claims typically allege that insurance companies or their affiliates improperly collect an excessive advisory fee for their annuity investment options to when a sub-advisor is doing all the work. See Excessive Fee Cases and Trend in Excessive Fee Decisions. The ERISA claims allege that annuity fees are excessive due to revenue sharing or other factors. See Excessive Fees—Different Theory.
- Life Insurance policyholders are challenging increases in their cost-of-insurance (COI) charges. They claim that these increases are based on factors that are not contractually permissible; or that these increases discriminated against certain classes of policyholders; or that the impending increases were not properly disclosed to purchasers of policies. See Recent Cost-of-Insurance Decision and Captive Reinsurance/Cost-of-Insurance Complaint.
- All insurers have been subject to claims that they are not offering the lowest-cost investment options and services. For example, they have been sued under ERISA for offering stable value funds or similar products that earned an allegedly excessive interest rate “spread.” See Stable Value Funds. Other retirement plan complaints that may ultimately affect the insurance industry assert that charging more than a small per-participant rate for administrative services, and not offering the lowest cost collective trusts and stable value funds on the investment menu, violate ERISA. See ERISA—Shape of Things to Come.
- Finally, insurers have been subject to “captive reinsurance” claims. They are accused of creating the misleading impression that life or annuity risks are being independently

reinsured when in fact they are retained within an affiliated company. See Captive Reinsurance Class Actions. These captive reinsurance claims have been coupled with "COI increase" allegations in one recent case. See Captive Reinsurance/Cost-of-Insurance Complaint.

It is true that there have been a few favorable decisions for the industry. Most notably, a federal appeals court concluded that insurance companies do not owe ERISA fiduciary duties when negotiating their fees with a retirement plan and retaining the discretion to increase those fees. See 8th Circuit Excessive Fee Decision. Another federal appeals court ruled that there is nothing inherently misleading about a "bonus annuity," and that insurance companies have no duty to disclose its internal pricing policies for their products. See Annuity Cases—Good 9th Circuit Decision.

The future looks unsettled in some of these areas because of the Department of Labor's proposed fiduciary rule, which could impose a fiduciary standard on many companies that sell investment products to retirement investors. This would compound the litigation risks highlighted above while creating others. The final DOL rule is expected to be announced shortly.