
Life and Annuity Series: Cost-of-Insurance Charge Litigation – October 2017 Update

OCTOBER 2, 2017

Four recent cost of insurance (COI) decisions were handed down over the summer of 2017. Three of these decisions preserved the plaintiffs' claims, even though the insurers had the express contractual right to increase COI charges for a number of different reasons. The fourth decision provides support for some defenses in these cases.

1. *In re Lincoln National COI Litigation*

The Pennsylvania federal court declined to dismiss numerous consolidated class actions against Lincoln National that claimed (among other things) Lincoln had increased COI rates in 2016 for its life insurance policies, in amounts ranging from 50% to 95%, based on factors not provided for under the policies.

Specifically, Lincoln had discretion under the policies to set the COI rates resting on its expectation of future mortality, interest expenses and lapses. Nevertheless, the plaintiffs alleged that Lincoln had dramatically increased COI rates not after considering these factors, but rather to recoup past losses (resulting from low interest rates, poor portfolio management, lower investment income and higher reinsurance rates) and to manage profitability (by inducing “shock lapses” of policies, particularly by the elderly). To support their allegations, the plaintiffs relied on Lincoln's statements to policyholders and the public explaining the reasons for these COI increases.

The court concluded that while some of Lincoln's stated reasons for the COI increases related to changes in the future expectations permitted by the policies, other statements “could be construed as suggesting that the decision was backward-looking and based, at least in part, on past ‘persistent low interest rates’....” The court also credited the plaintiffs' allegation that, generally, mortality rates had improved nationwide (and thus would not support a COI increase), and discounted Lincoln's responses that such nationwide trends (i) do not amount to a plausible claim in the specific circumstances of Lincoln's rate classes and (ii) do not mean that any improvements have matched the improvements expected back when the policies were first issued and the COI rates were first set.

2. *EFG Bank v. Transamerica Life Insurance Co.*

The California federal court declined to grant Transamerica's motion to dismiss individual plaintiffs' claims alleging that COI increases in 2015 ranging from 5% to 91% did not result from Transamerica's expectations of future costs, and were an impermissible attempt to circumvent a minimum guaranteed interest rate and to recover past losses.

The court recognized that Transamerica had discretion to change COI rates as a result of its future expectations of numerous future cost factors, "including but not limited to" mortality, expenses, interest, persistency and taxes. Despite this broad range of factors, the court started from the premise that Transamerica did not have unfettered discretion to change COI rates and that "mortality is a significant cost factor" in any COI increase. It then concluded that the plaintiffs had stated a plausible claim that the COI increases were not driven by changes in mortality but instead included impermissible factors, based on plaintiffs' allegations that the COI increases were dramatic, that mortality expectations have improved over the past 20–30 years, and that Transamerica had not stated in its 2011–2015 regulatory filings that its anticipated mortality was worse than its current experience.

The court also decided that plaintiffs had stated a separate claim for breach of good faith and fair dealing based on allegations that Transamerica had exercised its discretion to unfairly frustrate the agreed purposes of the policy, and was deliberately trying to induce policy lapses or surrenders by forcing policyholders to otherwise pay "exorbitant premiums."

3. *DCD Partners v. Transamerica Life*

The same California federal court also denied Transamerica summary judgment on similar class action claims for breach of contract, breach of good faith and fair dealing, and unfair competition. The court concluded that there were material issues of fact regarding Transamerica's "true expectations" about mortality when it increased its COI charges, and whether Transamerica allegedly "contrived" the reasons for the COI increases to "justify an increase of a certain magnitude and thereby increase profits."

The court ruled that testimony from an actuary at Transamerica—that the COI increases resulted from anticipated future mortality costs—was not dispositive. The court found that the underlying actuarial work (which did not reference any previous mortality assumptions) may have been "designed" to result in a substantial COI increase rather than an accurate determination about future mortality.

4. *Kalodner v. Genworth Life and Annuity*

The Pennsylvania federal court granted in part Genworth's motion to dismiss an individual plaintiff's claims alleging that COI charges had been improperly increased by 46% in violation of the formula set forth in a whole life policy. The plaintiff alleged that Genworth had not only considered the four permissible factors of mortality, interest, expense and persistency, but also had engaged in impermissible "modeling" of pricing assumptions to arrive at an acceptable profit margin.

Despite the language permitting COI increases for “persistence” reasons, the court rejected Genworth’s argument that the policy unambiguously authorized it to consider premium persistence and patterns when setting the COI. Thus, the court held that plaintiff had stated a claim for breach of the insurance policy when Genworth considered such premium patterns in setting the COI charges.

However, the court also dismissed plaintiff’s claims that Genworth had engaged in impermissible “modeling” of pricing assumptions to achieve a profit when that modeling occurred *after* Genworth had established pricing assumptions based on the four permissible factors (mortality, interest, expense and persistence). According to the court, the policy language did not prohibit Genworth from modeling to achieve a profit either *before* or *after* establishing its pricing assumptions based on the four permissible factors.

Moreover, the court rejected the plaintiff’s claim that Genworth had an obligation to recalculate its mortality expectations based on a nationwide decline in mortality rates. The court concluded that the policy language (which specified the 1980 CSO Table, and permitted a change in COI rates as a result of expectations of future mortality) did not impose on Genworth “any requirement that [it] reassess its expectations and alter the rate accordingly” based on updated trends developed during 1990–1995.

Authors



**Andrea J.
Robinson**

RETIRED PARTNER

📞 +1 617 526 6000