

The Price Of Mortality: Cost-Of-Life-Insurance Cases

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Plaintiffs lawyers have been challenging cost-of-insurance (COI) charges for years, with mixed results. The following outline reviews the most recent flurry of cases.



Charles Platt

The Phoenix Life Decision

In *Fleisher v. Phoenix Life* (April 2014), the United States District Court for the Southern District of New York rejected in part the policyholders' claims that COI increases were not justified by the terms of the universal life (UL) contracts, but left the door open on two other issues.

Specifically, the policyholders alleged that their UL contracts only permitted an increase in their COI rates based on six enumerated factors in their policies: "expectations of future mortality, persistency, investment earnings, expense experience, capital and reserve requirements and tax assumptions." Phoenix Life allegedly breached those contracts by: (1) increasing COI charges for policyholders who had "low funding rates" and low policy values, (2) applying discriminatory COI increases against only a certain "class" of UL holders and (3) designing the COI increases to recoup prior losses, not address future expectations. These claims were based on similar allegations by the New York Insurance Department that had been settled by Phoenix Life.

The SDNY determined first that the six factors enumerated in the contracts were "exhaustive," not "illustrative," and thus unambiguously prevented Phoenix Life from increasing COI charges based on other factors. However, the court went on to decide that Phoenix Life could raise the COI based on policyholders' funding rates and policy values, as they were logically tied to one of the six factors: the company's expectations of investment earnings.

The SDNY thus granted Phoenix Life's summary judgment motion in part. But it held that there was a question of fact as to whether the insurer had unfairly discriminated by imposing the COI increases only on two groups of policyholders without a proper underwriting basis (i.e., for profitability, not actuarial, reasons). The court also held that there was a question of fact whether the COI increases were to recoup prior losses rather than for future expectations.

The Lincoln National Decision

Lincoln National Insurance Co. v. Bezich (June 2015) also turns on whether the permissible factors for a COI increase are limited by the terms of the life insurance policy.

The Indiana court of appeals held, in certifying a class, that the policy language unambiguously prevented Lincoln National from "pad[ding] the COI rate" with expenses unrelated to mortality expectations. It relied on policy language stating:

The monthly cost of insurance rate is based on the sex, issue age, policy year and rating class of the insured. Monthly cost of insurance rates will be determined by the company based upon expectations as to future mortality experience.

In the court's view, this language connoted "exclusivity": only mortality factors could be considered in setting COI charges. The court also criticized what it called Lincoln's "absurd" interpretation of the COI rate provision to permit Lincoln to unilaterally increase COI rates to reflect worse-than expected mortality, but not reduce those rates in the event of mortality improvement. The court disapproved of Lincoln's "heads we win, tails you lose" power.

The California Law Decisions

A California federal court has permitted claims against an insurer for purportedly exceeding its discretion in increasing COI charges. In *DCD Partners LLC v. Transamerica Life Insurance Co.* (August 2015), the court concluded (among other things) that the plaintiff policyholders had stated a plausible claim for breach of contract by alleging that the insurer increased its COI charges by 135 percent, which supported an inference that the increases were for impermissible reasons of "profitability and racial animus," rather than the for permissible "cost factors" in the policy. The court also determined that the policyholders had stated a claim for breach of good faith and fair dealing, by alleging that the insurer had increased COI charges "in bad faith." The court recognized that the insurer had considerable discretion to increase the COI, but that discretion was limited by the enumerated "cost factors" in the contract. Those limitations implied a covenant that the insurer would increase its rates only in good faith.

The court in *DCD Partners* relied on another decision by the SDNY involving Phoenix Life, titled *United States Bank Association v. PHL Variable Insurance Co.* (June 2015). There, the SDNY held that an implied covenant of good faith under California law could apply even if the insurer had discretion to raise its COI rates. In particular, there could be such a claim if Phoenix Life had set its rates at levels designed to deter policyholders from exercising their contractual rights to pay only minimum premiums, or at levels designed to discriminate against policyholders or force the lapse of their policies, or at levels designed to manage Phoenix's profitability.

The AXA Equitable Complaints

Two class action complaints against AXA Equitable (SDNY and S.D. Fla. Feb and March 2016) pursue the theory that COI increases must be based only on the specific factors in the contract, but also raise the claim that COI increases unfairly discriminate among classes of policyholders.

Specifically, both of these complaints allege that AXA's UL policies were originally marketed based on the promise of "minimum premium" payments, but that the company later "targeted" for COI increases the policies that had lower accumulated policy values based on those "minimum premium" payments. The COI increases allegedly forced policyholders to either pay newly-increased premiums not justified by the death benefits, or to lapse their policies and

“forfeit” premiums already paid. AXA purportedly was recouping profits it lost due to the underperformance of its policies overall.

The class complaints assert that the COI increases were not permissible under the AXA contracts, which provided for COI increases only based on “assumptions as to expenses, mortality, policy and contract claims, taxes, investment income and lapse ...” Similarly, the plaintiffs asserted that AXA’s COI increases were not based on reasonable actuarial assumptions, since mortality experience has improved substantially overall, and AXA had reported in its 2014 annual statements that its experience factors had not changed. Finally, the COI increases were claimed to have discriminated against certain groups of policyholders — those who “minimum funded” and those with issue ages over the 70 with current face values of more than \$1 million, without a reasonable actuarial basis.

The Banner Life Complaint

The class action complaint against Banner Life (D. Md. Jan. 2016) asserts a new theory for why COI increases are not justified by the contract language: Banner Life’s COI increases were improperly driven by its “captive reinsurance” arrangements that had caused financial problems, and thus the increases were not based on unexpected investment, mortality, lapse and expense experience that would be justified under the contracts.

The plaintiffs also try to distinguish themselves by pointing to their “no lapse guarantee” policies. They say they were induced by Banner Life’s falsely-optimistic financial statements into making “excess premium” payments (and locking up money in the policy), rather than making “minimum premium” payments (and thereby retaining more financial flexibility) if Banner had made accurate disclosures about its captive reinsurance arrangements.

Finally, this complaint sets forth more specific policy data than usual, which allegedly show that the size of Banner Life’s COI increases was not justified based on reasonable actuarial assumptions. These allegations make it more difficult to dispose of the case as a matter of law.

The Transamerica Complaint

The class action complaint against Transamerica Life Insurance Co. (C.D. Cal, Feb. 2016) skips past the policy language altogether, alleging that Transamerica improperly increased its COI rates to address losses it has incurred on above-market interest guarantees in its policies.

Instead of setting forth the actual policy language governing COI increases, plaintiffs allege that a “reasonable policyholder” would have interpreted Transamerica’s UL policy to only permit COI increases based on increased mortality rates. They then go on to assert that increased mortality could not have been the real basis for Transamerica’s COI increases, as mortality rates have been dropping overall for the general public. Moreover, Transamerica had represented to regulators in each of the prior four years that there was no expectation of the need to increase COI rates, as part of “captive reinsurance” arrangements that permitted Transamerica to upstream dividends to its parent Aegon. The real reason for the

COI increases, plaintiffs suggest, was so that Transamerica could either offset the above-market guaranteed interest rates on its policies, or alternatively cause policyholders to terminate those high-interest policies to avoid paying the increased charges.

The complaint alleges that Transamerica breached the UL contracts because even if the COI increases were based in part on legitimate factors, the size of the increases meant that they must have resulted from impermissible factors as well. The complaint also asserts claims for unfair competition based on the misleading marketing of these policies, and elder abuse claims based the disparate impact that these COI increases have on elderly policyholders.

Observations

Plaintiffs continue to construct reasons why COI increases are not based on legitimate factors enumerated in the standard contract language. In light of these efforts, it is important for companies to carefully support any COI increases with actuarial assumptions that fall comfortably within the factors permitted by their contracts and that fully support the fact and the amount of the increase.

Since courts have been receptive to claims that COI increases cause “unfair discrimination” and “recoup lost profits,” companies should expect more of those allegations. Similarly, exceptionally large increases could drive claims that there has been a breach of the duty of good faith and fair dealing. The Transamerica complaint raises the risk of more elder abuse claims.

These COI complaints are likely driven by life settlement holders, who hold large face amount policies originally purchased by elderly policyholders, and who have based their yield projections on paying low minimum premiums that will now be significantly increased.

The AXA complaints foreshadow COI increases being cast as “sales practice” claims. Those claims may eventually question whether companies knew some time ago that mortality expectations for certain classes of policyholders would grow worse over time, but nevertheless maintained COI rates at artificially low levels in order to sell more policies, knowing that they could raise rates after they “locked in” policyholders with surrender charges; and whether companies knew that life settlement companies were buying their policies, which would eventually reduce lapse rates, policy values and investment results and thereby cause COI charges to go up, but nevertheless maintained COI rates at artificially low levels despite this knowledge, all in order to sell more policies (again knowing that surrender charges would “lock in” those policyholders).

—By Charles Platt, WilmerHale

[Charles Platt](#) is partner-in-charge of WilmerHale’s New York office who specializes in Securities, Litigation/Controversy, and Regulatory and Government Affairs.

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